JAMES ALPHA GLOBAL REAL ESTATE INVESTMENTS FUND

Market Commentary Newsletter
Provided by Ascent Investment Advisors, LLC
December 2015

Performance Review

2015 has been a year of monetary policy divergence amid a backdrop of slowing global growth, a combination that led to periods of significant volatility. In January, the European Central Bank (ECB) announced an aggressive quantitative easing (QE) program just as the U.S. Fed's balance sheet peaked. Over the year, the People's Bank of China (PBoC) cut rates and bank reserve requirements six times and surprised markets with a small depreciation of the Yuan. In December, monetary policy divergence continued with the ECB lowering its deposit rate to -0.3% and committing to extending its QE program by six months into 2017, while the Fed increased interest rates by 25 basis points for the first time since 2006.

In addition to being a volatile year, 2015 was also a forgettable year for global REIT returns – the Global REIT Index ended the year up just 0.05%. Most markets were lackluster, with Japanese and eurozone REITs providing the best returns among the major markets, validating two of our calls throughout the year.

It's likely that the key events that will shape the global economy and REIT markets in 2016 have already happened, in the closing weeks of 2015. December saw three meetings by the ECB, OPEC and finally the U.S. Fed, which between them have set the tone for global investors for the first part of 2016, and quite likely the rest of the year.

With the loosening in policy by the ECB followed by the first Fed rate rise only two weeks later, we had decisive confirmation that monetary policy on both sides of the Atlantic is on divergent paths. Many developed market central banks have tried to raise policy rates since the global financial crisis, while none has been able to make the rate rise stick. In 2016, we find out whether the world's most important central bank will be the first and manage to follow that rate rise with a few more. More important for investors than the exact timing of this first U.S. monetary policy tightening is the pace of subsequent rate rises, which was a key focus on the day of the December move. The strength of U.S. consumption and investment will be important in paving the way for continued gradual normalization.

The eurozone grew by approximately 1.5% in 2015 and is projected to do slightly better in 2016, though much will depend on whether private investment finally starts to pick up. The most encouraging feature of the past 12 months has been the relative strength in the periphery of the eurozone, notably Italy and Spain, and the pickup in domestic demand due to higher consumer confidence and the fall in the price of oil.

In 2015, Japan has once again struggled to put years of intermittent growth behind it. The Bank of Japan (BoJ) has made progress in increasing inflation, but will not come close to reaching its target of 2% in 2016. Both employment and lending growth look healthy relative to the years since the global financial crisis, and micro-economic data such as jobs growth at small companies suggests that structural reforms are having an effect. Although there are improvements in corporate governance in key parts of the market, "Abenomics" clearly has a long way to go.

China saw a significant slowdown in the core industrial side of its economy through 2015 and continues to have a significant disinflationary effect on the global economy. In effect, the industrial side of the economy has already had a "hard landing," but services have been more resilient and now account for a much larger share of GDP than a decade ago. China's ongoing challenge is to manage this cyclical slowdown without undermining the structural move to a more consumer-oriented economy, which would be good for global imbalances as well as being good for China. In the latter part of 2015 there were signs that China's steps to provide fiscal and monetary stimulus were helping to stabilize their economy. If so, that could reduce the pressure for China to use further exchange rate depreciation to revive net exports and reverse deflation.

Market Outlook

Looking ahead, we retain our broadly constructive outlook for global real estate fundamentals and listed REIT returns, but we also remain mindful of the risks. The emerging markets slowdown is constraining global growth, momentum in the U.S. and Europe is moderating and Japan faces stronger headwinds. The risks of policy missteps in China have manifested, raising the prospect of further volatility.

As we head into 2016, all eyes are on the Fed as it takes its first step toward policy normalization since the financial crisis. Meanwhile, concerns about China's slowdown suggest that episodes such as the risk-off sell-off that we saw in August could recur. These headwinds, however, do not imply a retreat from global REITs in the near term. The early stages of U.S. tightening have not derailed property stocks in the past. Moreover, the REIT market's eventual resilience following the Fed's decision to cease QE in October 2014 provides recent evidence of the market's relatively relaxed approach to the withdrawal of extremely loose monetary conditions. With valuations now below their long-term average, the key to the outlook for global REITs rests with earnings. Regionally, we expect the strongest earnings growth to come in Europe, while the early stages of the Fed tightening cycle should favor non-U.S. REITs.

Monetary policy divergence will be a key theme in 2016. With the U.S. and UK at or near full employment, the Fed and the Bank of England should gradually tighten monetary policy this year while the ECB, the BoJ, and the PBoC should maintain an easing bias.

With the eurozone less advanced in their economic cycle, we see scope for European real estate stocks to continue to outperform the U.S. Japan was the best-performing developed market in 2015. That looks less likely in 2016, especially if the BoJ decides that the economy is doing well enough to manage without further easing.

The primary downside risks are currency-induced dislocations due to policy missteps by the Fed, the ECB, and/or the PBoC, and greater than expected weakening in global growth due to further weakness in emerging markets and the disinflationary forces coming out of China. Political risks are also a concern, particularly the UK referendum on EU membership, the European migrant crisis, and the general election in the U.S.

The size of China's economy makes what happens there important for growth not just in the emerging markets but everywhere around the world. In this regard, China may well be the key to global economic growth in 2016. While some argue that China cannot avoid a hard landing, China has ample foreign exchange reserves and still maintains very tight control of its capital accounts, borders, and currency. Against this backdrop, our baseline expectation remains a slow deceleration in economic growth accompanied by a slow acceleration in implementing policy reforms. We expect China's growth will remain at or slightly below the 7% target, as China passes the turning point of its transition from a manufacturing-led to a services-driven economy. Following recent volatility we think policymakers will prioritize stability in the near term. The services sector is strengthening but not yet offsetting the slowdown in investment and manufacturing. The property market's stabilization is encouraging. Looking ahead, we expect further targeted stimulus by the PBoC as financial conditions remain tight.

Eurozone growth momentum has leveled out. The refugee crisis has replaced the Greek exit risk as the dominant policy challenge. The ECB is likely to expand QE in early 2016, and we see European property stocks outperforming the U.S. given their relatively undemanding valuations on trough earnings.

Japan faces a possible relapse into recession, and we think the BoJ is likely to ease again in the next six months. We see Japan's growth at 0.5% this year and 1.1% in 2016. Consumption is still soft, and weak Asian demand is weighing on exports. Wage growth has been disappointing, and Yen depreciation has stalled.

Our base case outlook for 2016 is for a continuation of the bull market in global REITs, predicated on:

1. Continued strong industry fundamentals (cash flow growth of 4%-6%);
2. Long-term rates remaining a tailwind (10-Year Treasury yield below 3.5% and likely to stay below 3%) as Fed tightening acts to "tap on the brakes" and slow an already weak economy, reducing the marginal demand for (and cost of) capital;
3. Muted supply, as additions from development are still tracking below the rate of demolition of old, obsolete space; and,
4. Geographically, non-U.S. will outperform U.S. as the major foreign central banks (ECB, BoJ, PBoC) are still in the early stages of easing cycles while the U.S. Fed embarks on a tightening effort.

With global central bankers still willing to provide support until job creation broadens and growth becomes self-sustaining, we believe the bull case for global REITs remains intact. Despite the length of the current bull market, we remain focused on the truism that bull markets don't die of old age, they die of excesses. For real estate, that means excess new supply from development, which continues to be muted. Gains will be tougher to come by which means that selectivity and stock-picking have become increasingly important.

We note that the only scenario wherein the Fed would begin to actually tighten is a scenario of sustainable economic growth — which is also inherently bullish for commercial real estate fundamentals, thus offsetting much of the negative impact of higher interest rates. We expect there will be occasional corrections as equities adjust to higher rates, but we intend to use those pullbacks to add to growth-oriented REITs, particularly in Europe and Asia-Pac.

There's also a wild card which we expect could and likely will favorably impact REIT returns in 2016 (and beyond). In a hat tip to the listed REIT sector, the S&P announced that in mid-2016 it will elevate REITs as a standalone sector in their Global Industry Classification Standard (GICS). Currently, REITs are classified under Financials where they've been "hidden" from institutional allocators, allowing most of them to ignore REITs and get their real estate exposure via direct ownership and private equity funds. Now that REITs have been placed in the S&P GICS spotlight, institutions will be forced to take a stand on REITs and justify their lack of exposure if they have none. If we assume that the institutions who have been ignoring REITs do no more than adopt a neutral-weight position, that alone would drive inflows of many tens of billions. To put that in context, the total AUM of all REIT funds (domestic-only plus global) is approximately $130 billion. Clearly, this could be a game changer for REITs and keep a strong bid under REIT shares as investors adjust to the higher profile of listed real estate. The creation of a dedicated real estate sector also acknowledges that there are fundamental differences between real estate companies and other businesses. Segmenting coverage and highlighting performance attribution of real estate will promote awareness of the sector’s distinct investment characteristics and low correlation with other asset classes. We expect this to serve as a catalyst for continued growth of the listed real estate market, giving investors access to a wider range of opportunities and enhancing liquidity, resulting in a lower risk premium and cost of capital, which in a spread investment business model translates into higher risk-adjusted returns.

DEFINITIONS

Abenomics: Nickname for the multi-pronged economic program of Japanese Prime Minister Shinzō Abe. The program seeks to remedy two decades of stagnation by increasing the nations' money supply, boosting government spending and enacting reforms to make the economy more competitive.

Bank of Japan (BoJ): The Bank of Japan is the Japanese central bank. The bank is responsible for issuing and handling currency and treasury securities, implementing monetary policy, maintaining the stability of the Japanese financial system, and providing settling and clearing services.

European Central Bank (ECB): The central bank of the euro and administers monetary policy of the Eurozone, which consists of 19 EU member states and is one of the largest currency areas in the world.

Gross Domestic Product (GDP): The monetary value of all the finished goods and services produced within a country's borders in a specific time period.

Organization of Petroleum Exporting Countries (OPEC): An organization consisting of the world's major oil-exporting nations. OPEC was founded in 1960 to coordinate the petroleum policies of its members, and to provide member states with technical and economic aid. OPEC is a cartel that aims to manage the supply of oil in an effort to set the price of oil on the world market, in order to avoid fluctuations that might affect the economies of both producing and purchasing countries.

People's Bank of China (PBoC): The central bank of the People's Republic of China with the power to control monetary policy and regulate financial institutions in mainland China. The PBoC has more financial assets than any single public institution, and is second only to the Federal Reserve System of the United States in terms of overall central bank assets.

Quantitative Easing (QE): An unconventional monetary policy in which a central bank purchases government securities or other securities from the market in order to lower interest rates and increase money supply.

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Andrew Duffy is the President of Ascent Investment Advisors, LLC and the Senior Portfolio Manager of the Global Real Estate Investments Fund (JAREX/JACRX/JARIX), a mutual fund that invests in publicly-traded global REIT securities. Mr. Duffy has more than 20 years of global real estate securities investment experience.

Prior to joining Ascent Investment Advisors, Mr. Duffy was a Managing Director with Citigroup Principal Strategies, where he managed a long/short portfolio of global real estate securities. From February 2005 until January 2008 he was with Hunter Global Investors, L.P. where he was the Co-Portfolio Manager of the Hunter Global Real Estate Fund, LP. Before that he was a portfolio manager at TIAA-CREF for over six years, during which time he was directly responsible for managing over $3 billion in global real estate equity and debt securities. Between 1993 and 1999, Mr. Duffy was a Senior Research Analyst at Eagle Asset Management, where he launched and managed a dedicated real estate securities investment program.

Prior to his career in investments, Mr. Duffy served for five years as an officer in the United States Army, where his assignments included serving in the 7th Special Forces Group and the 82nd Airborne Division. Mr. Duffy received a B.S. from the United States Military Academy at West Point in 1979 as a Distinguished Graduate (top 5% of class) and an M.B.A. from Harvard Business School in 1986. He earned the Chartered Financial Analyst designation in 1996.

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Investors should carefully consider the investment objectives, risks, charges and expenses of the Fund. This and other information is contained in the Fund's prospectus, which can be obtained by calling (888) 814-8180 and should be read carefully before investing.

As with any investment, there are multiple risks associated with REITs. Risks include declines from deteriorating economic conditions, changes in the value of the underlying property, and defaults by borrowers, to name a few. Please see the prospectus for a full disclosure of all risks and fees.

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