ASCENT INVESTMENT ADVISORS

Market Commentary Newsletter
July 2015

Performance Review:

Global markets in July were dominated by discussions about the timing of U.S. interest rate hikes, intensification of the Greek crisis and Chinese equity market volatility. Events during the month did little to clarify the exact timing of the first U.S. rate hike in more than nine years. Amid mixed progress for the U.S. economy, the Fed's July policy statement pointed towards steady improvement in the labor market and further improvement in the housing market, while keeping the characterization of consumer spending as "moderate." There were no changes to the Fed's policy stance and it remained hedged on the timing of impending rate hikes. Based on Fed funds futures, the chance of a rate hike in September is roughly 60%, with the odds poised to be pushed in one direction or the other by the July employment report due out on August 7th.

A lower-than-expected employment cost index reading and GDP growth number released late in the month did little to resolve the interest rate call. A significant upward revision to first quarter growth was counterbalanced by slightly disappointing headline growth data for the second quarter. In any case, the Fed has recently been strongly signaling that rates will rise in 2015. Confidence in a September move was shaken by news that the employment cost index, a closely watched measure of wage growth, had risen just 0.2% in the second quarter — the weakest quarterly gain since records began in 1982. The dollar fell and government bonds rallied sharply on the news, suggesting the market believes wage weakness may delay a Fed move.

The long-running Greek crisis came to a head in early July, with the country only narrowly avoiding exit from the euro area. The deal eventually struck was stricter than what had gone before, making the passage of numerous economic reforms a pre-condition for even the start of negotiations on a third bail-out package. For now, the problem seems to have been kicked down the road yet again, leaving us wondering for how long. The relatively harsh deal leaves Greek domestic politics under considerable strain. Early elections could quickly bring the issue back into market focus. This latest crisis round seems to have had limited economic impact outside Greece. With the European Central Bank (ECB) standing ready to intervene, peripheral bond yields have remained contained and bank deposits steady. Early indications suggest some damage to European consumer confidence, but with business confidence unaffected. Thus, our positive outlook for the European economy and REITs over the medium-term remains intact. In the near-term we take a slightly more cautious view of European real estate stocks until we are convinced the deal in Greece will prove durable.

The slump in Chinese equities that started in June continued to occupy headlines in July, but the market stabilized and the declines partly reversed early in the month on the back of increasingly aggressive intervention by the government. Volatility and weakness returned towards the end of the month and it remains to be seen whether further intervention will be required. The knock-on effect on the Chinese economy is unclear. A relatively limited share of China's household wealth is invested in the stock market, so the transmission effect is muted. While consumer confidence seems unscathed, the latest Chinese Purchasing Managers Index (PMI) readings suggest renewed weakness following the stabilization in economic activity data during the second quarter.

In Japan, the slump in oil prices over the past year has added to the challenges Japan's central bank faces as it tries to boost inflation through a massive program of monetary stimulus. In Australia, the Reserve Bank of Australia (RBA) kept rates unchanged following interest rate cuts at both of the last two meetings.

Our Market Outlook:

The tentative bail-out agreement in Greece and a better-than-expected GDP report in China have eased concerns over those two countries as sources of uncertainty for risk assets. Meanwhile, improving U.S. and European growth should shift investor attention back to the improving global fundamentals. Implementation risks hang over both the Greece deal and China's policy interventions. Yet, the renewed decline in oil prices could further strengthen global growth, fueled by expectations of a lifting of sanctions against Iran.

The U.S., China, the Eurozone and Japan account for nearly two-thirds of global economic activity; thus, these areas are where global growth matters the most. The market expects that global GDP growth will accelerate in 2015, 2016 and 2017, aided by lower oil prices and stimulus from two of the three leading central banks in the world. That said, the likelihood of rate hikes in the U.S. in late 2015 and the U.K. in early 2016 is a potential growth headwind. Still, much stimulus remains in the system, and more is likely from the Bank of Japan (BoJ) and the ECB, which may help bolster growth prospects in two key areas of the globe. Although China is unlikely to embark on quantitative easing (QE), Chinese authorities have recently enacted a series of targeted fiscal, monetary, and administrative actions aimed at stabilizing China's economy in 2015 and beyond, and more such actions may follow.

The outlook for global growth matters to real estate investors because it defines the ultimate pace of activity that creates value for countries and companies. The latest economists' consensus forecast for 2015 global GDP growth stands at 2.8%, up from the 2.7% expected three months ago in April 2015 and unchanged from where estimates for 2015 global GDP growth stood at the start of 2015. A year ago, the consensus expected 3.1% growth in 2015; and in early 2013, the consensus expected 3.4% world GDP growth. The downward revisions to 2015 global growth estimates are nothing new. Consensus estimates for global GDP growth have been consistently revised lower since at least 2010. Consensus estimates for global growth in 2016, which stood at 3.2% in July 2015, have also been moving lower since the start of 2015 (3.2%) and since 2016 estimates were first compiled in early 2014 (3.3%). Here again, this should neither surprise nor concern global investors, as global growth estimates are almost always revised lower over time. Looking out to 2017, global growth estimates have remained steady at 3.2%.

Estimates for U.S. GDP growth for 2015 stand at 2.3% at mid-year, down from 3.2% at the start of the year and from the 3.0% forecast a year ago. The drop in oil prices, the stronger dollar, and probably most significantly, the poor start to 2015 (due to bad weather and the West Coast port strikes) account for most of the decline. The consensus estimate for 2016 (at 2.8%) hasn't moved much in the past year, and the consensus is looking for a 2.7% growth rate in 2017.

The consensus expects 7% GDP growth in China this year and 6.5%-7% growth in 2016 and 2017 — and like global growth estimates, the consensus estimates for Chinese economic growth have been moving lower for years. All else being equal, the recent drop in oil and commodity prices should be a net positive for China's growth prospects, but Chinese authorities have continued to struggle to implement the correct mix of monetary, fiscal and regulatory policy to help guide China's economy from an export-led manufacturing economy to a more domestically oriented consumer economy. Over the past few years, China's property bubble gave way to a property price bust, and some of that "hot" money went into Chinese domestic equities, which soared by more than 160% between mid-2014 and mid-2015, before dropping 30% between early June and early July 2015. In our view, the 30% drop in Chinese equities over the past month does not represent any new information about China's fundamentals any more than the 160% gain between mid-2014 and mid-2015 did. In fact, the 160% gain in Chinese stocks in 2014 and early 2015 was accompanied by generally deteriorating fundamentals for the Chinese economy and many Chinese property companies.

Despite the never-ending saga of Greece and its place in the Eurozone, and bucking the usual trend of downward revisions to growth over time, GDP growth prospects in the Eurozone have been revised higher for 2015 and 2016 since the start of 2015. Actions by the ECB to enact QE earlier this year, which helped to heal Europe's fractured banking system, have contributed to positive growth prospects in Europe. Europe is also benefiting from lower oil prices, and a quick resolution of the latest issues in Greece may provide a confidence boost. At mid-year 2015, the consensus expects 1.5% GDP growth in the Eurozone in 2015, accelerating to 1.7% in 2016.

The BoJ is in a "wait and see" mode after enacting QE in early 2013 and then increasing the size of the QE program in late 2014. It has promised to do more if GDP growth in Japan falters or if deflation in Japan persists. Consensus GDP estimates for Japan in 2015 stand at 1.0% at mid-year 2015, unchanged from the estimates made at the start of 2015. Growth estimates for 2016 have been revised significantly higher over the past year, and now stand at 1.4%, up from 1.1% at the start of 2015 and 0.8% a year ago. While deteriorating demographics and large public debt levels will continue to weigh on Japanese growth in the coming years and decades, Japan is now consistently adding to global growth prospects for the first time in many years.

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. We repeat our mantra that we continue to see commercial real estate, and by extension global REITs, as in the middle stages of a long-term bull market predicated on the "goldilocks scenario." 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 and below the rate of demolition of old, obsolete space.

We also 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.

DEFINITIONS

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.

Employment Cost Index (ECI): A quarterly report from the U.S. Department of Labor that measures the growth of employee compensation (wages and benefits). The index is based on a survey of employer payrolls in the final month of each quarter. The ECI tracks movement in the cost of labor, including wages, fringe benefits and bonuses for employees at all levels of a company.

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.

Purchasing Managers Index (PMI): An indicator of the economic health of the manufacturing sector. The PMI index is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

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.

Reserve Bank of Australia (RBA): The Reserve Bank of Australia is Australia's central bank and its main responsibility is to be involved in Australia's monetary policy. In addition, the RBA is also involved in banking and registry services for federal agencies and some international central banks. The RBA is tasked with contributing to three objectives: a) The stability of Australia's currency, b) Maintenance of full employment in Australia and c) The economic prosperity of the people of Australia.

About the Author, ANDREW J. DUFFY, CFA:

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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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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