

A year of recovery for real estate

Global real estate enjoyed a strong end to the year, outperforming the broad equity index by 4% as inflation and structural winners trumped concerns over rising rates, offices and retail. The vaccine-fuelled recovery meant that it was in many ways a perfect year for real estate in select markets. The US real estate market stood out, delivering its best year ever, and was beaten only by the Indian real estate market. Low interest rates in combination with stimulus, strong demand with accelerating rental growth, increased inflation expectations, surging housing markets and a ramp-up in M&A were major drivers. Most of Europe, Asia and Japan suffered from renewed pandemic disruptions and slower economic growth leading to significantly lower performing real estate markets than the US.

Inflationary pressure continues to intensify driven by ultra-accommodative monetary policy and Covid-related disruptions. This is mainly a good thing for real estate assets which can be viewed as a partial inflation hedge since rent growth has historically outpaced inflation. Inflating prices can be passed on through rents, giving real estate assets a critical role in portfolio strategies. Property values may benefit as higher costs for land, labour and materials raise the economic threshold for new supply. Interest rates will likely increase next year and slow down the strong initial phase of the real estate cycle seen during the year. However, the fundamentals continue to be favourable which should mean another solid year for property stocks, especially in markets and segments that lagged in 2021 where SKAGEN m2 has its overweight. The fund ended the year with a strong absolute return thanks to disciplined stock picking, despite its underweight in the exceptional US market.

A record year for transactions

There were a record number of take-outs in the SKAGEN m2 portfolio over the past twelve months. In both Europe and the US there was a record number of real estate transactions. The high demand for real estate assets, low cost of capital and the valuation difference between segments, all explain the demand. In December, the German residential operator

Vonovia, undertook the largest ever equity raise for a real estate company globally to partially fund the acquisition of Deutsche Wohnen.

Contributors and detractors

The best contributor to fund performance in the quarter was Norwegian Self Storage Group which recovered after lagging peers, also helped by the bid for Swedish peer 24Storage on high multiples. US warehouse operator Prologis was the top performer on continued strong demand and rental growth in the segment globally. This is partly pandemic driven as customers want to have a just-in-case inventory build-up rather than a just-in-time strategy. The largest detractors were both Japanese, namely Mitsui Fudosan and Tokyu Fudosan which operate within pandemic sensitive segments.

Portfolio activity

During the year the fund initiated 12 new positions and sold out of 12. In the quarter we exited Icade after a failed IPO and the Chinese conglomerate CR Land following the Evergrande turmoil which brought with it a strong risk of spill-over effects. We bought into another US office operator Hudson Pacific Properties.

Outlook

The valuation picture entering 2022 is diversified, both in terms of geography and sub-sector. The US is generally expensive except for certain segments like office. Next year markets are likely to normalise, especially in the US. As growth begins to decelerate, real rates rise, and credit spreads widen. Earnings and dividends will be the primary driver of total returns. Europe – which lagged US performance almost four times last year – and Japan have a brighter outlook due to lower valuation and greater recovery potential. The APAC real estate market ended the year negatively and will provide select opportunities in the year to come, however Chinese developers will likely continue to battle systemic and financial headwinds.



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When it comes to sub-sectors, structural winners are reshaping the market and skewing valuation. The pandemic accelerated several pre-existing structural trends, widening the gap between winners and losers. Valuations should be viewed in the context of this reshaping. The industrial sector has experienced a renaissance as demand for warehousing and logistics has boomed; new technology-serving opportunities (datacentres and towers) have emerged; aging populations increase the need for healthcare; residential sectors have proved relatively resilient; and M&A is ongoing. These factors have driven strong secular growth in these areas. Meanwhile, the once-dominant retail sector continues to suffer from e-commerce threats at a time when balance sheets remain stretched, and the debate over WFH vs office working continues to rage. All this means that the composition of the global real estate market has shifted markedly.



Photo: Shutterstock

Stock picking is more important than ever as dispersion increases with earnings growth, financial health and valuation. We see sustainability as increasingly important. It is a key area of valuation differentiation between landlords with newer real estate largely commanding a rising occupier premium (including through green investment to decarbonise the sector), ultimately lowering the relative risk of the asset. Record dry powder for the sector will drive M&A activity further and push valuations in a positive direction. The single biggest short-term risk for the sector, besides unexpected and fast-rising real rates, is a rapid decline in economic growth. SKAGEN m2 continues to focus on resilient companies in trend-driven subsegments, with good cash flow generation and balance sheet structure. The fund is well positioned for most scenarios thanks to our investment philosophy and disciplined stock selection.

The fund gives access to a normally inaccessible global real estate market. The fund selects low-priced, high-quality real estate companies from around the world. The objective is to provide the best possible risk adjusted return. The fund is suitable for those with at least a five year investment horizon.

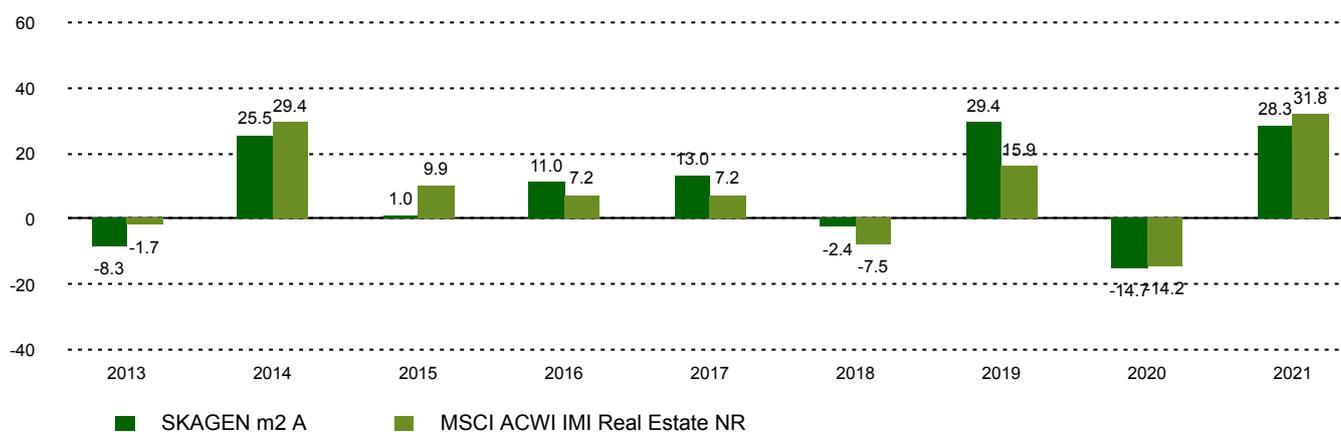
Historical performance (net of fees)

| Period | SKAGEN m2 A | Benchmark index |
|-----------------|-------------|-----------------|
| Last month | 4.5% | 5.6% |
| Quarter to date | 8.8% | 10.6% |
| Year to date | 28.3% | 31.8% |
| Last year | 28.3% | 31.8% |
| Last 3 years | 12.3% | 9.5% |
| Last 5 years | 9.3% | 5.4% |
| Last 10 years | n/a | n/a |
| Since start | 8.2% | 7.9% |

Fund Facts

| | |
|----------------------------|------------------------------|
| Type | Equity |
| Domicile | Norway |
| Launch date | 31.10.2012 |
| Morningstar category | Property - Indirect Global |
| ISIN | NO0010657356 |
| NAV | 27.88 EUR |
| Fixed management fee | 1.50% |
| Total expense ratio (2020) | 1.37% |
| Benchmark index | MSCI ACWI IMI Real Estate NR |
| AUM (mill.) | 183.39 EUR |
| Number of holdings | 34 |
| Portfolio manager | Michael Gobitschek |

Performance last ten years



In the period from 11 July 2017 to 30 September 2019, the benchmark was the MSCI ACWI Real Estate IMI ex REITS

Contributors in the quarter



Largest contributors

| Holding | Weight (%) | Contribution (%) |
|--------------------------|------------|------------------|
| Self Storage Group | 6.22 | 1.84 |
| Prologis Inc | 4.68 | 1.45 |
| UMH Properties Inc | 4.44 | 0.89 |
| Shurgard Self Storage SA | 4.31 | 0.81 |
| Catena AB | 4.57 | 0.71 |



Largest detractors

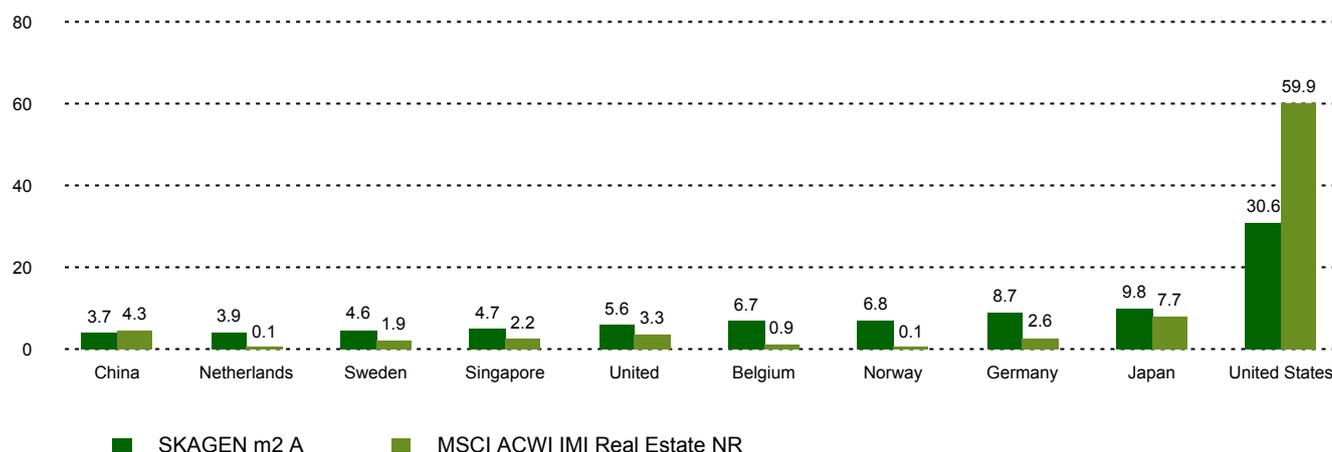
| Holding | Weight (%) | Contribution (%) |
|------------------------|------------|------------------|
| Mitsui Fudosan Co Ltd | 2.81 | -0.50 |
| Tokyu Fudosan Holdings | 2.90 | -0.29 |
| Aroundtown SA | 2.31 | -0.26 |
| Paramount Group Inc | 2.81 | -0.17 |
| Vonovia SE | 2.84 | -0.11 |

Absolute contribution based on NOK returns at fund level

Top ten investments

| Holding | Sector | Country | % |
|------------------------------------|------------------------|----------------|------|
| Self Storage Group ASA | Industrials | Norway | 6.8 |
| UMH Properties Inc | Real Estate | United States | 5.0 |
| Prologis Inc | Real Estate | United States | 4.9 |
| Catena AB | Real Estate | Sweden | 4.6 |
| Shurgard Self Storage SA | Real Estate | Belgium | 4.4 |
| Grainger PLC | Real Estate | United Kingdom | 4.1 |
| Switch Inc | Information Technology | United States | 4.1 |
| CTP NV | Real Estate | Netherlands | 3.9 |
| ESR Cayman Ltd | Real Estate | China | 3.7 |
| Vonovia SE | Real Estate | Germany | 3.4 |
| Combined weight of top 10 holdings | | | 45.0 |

Country Exposure (top ten)



■ SKAGEN m2 A ■ MSCI ACWI IMI Real Estate NR

In the period from 11 July 2017 to 30 September 2019, the benchmark was the MSCI ACWI Real Estate IMI ex REITS

Contact



+47 51 80 37 09



contact@skagenfunds.com



SKAGEN AS, Post Box 160, 4001, Stavanger, Norway

Important information

Unless otherwise stated, performance data relates to class A units and is net of fees. AUM data as of the end of the previous month. Except otherwise stated, the source of all information is SKAGEN AS. Historical returns are no guarantee for future returns. Future returns will depend, inter alia, on market developments, the fund manager's skills, the fund's risk profile and subscription and management fees. The return may become negative as a result of negative price developments. You can download more information including subscription/redemption forms, full prospectus, Key Investor Information Documents (KIID), General Commercial Terms, Annual Reports and Monthly Reports from our local websites or our local representatives. Statements reflect the portfolio managers' viewpoint at a given time, and this viewpoint may be changed without notice. This report should not be perceived as an offer or recommendation to buy or sell financial instruments. SKAGEN AS does not assume responsibility for direct or indirect loss or expenses incurred through use or understanding of this report. Employees of SKAGEN AS may be owners of securities issued by companies that are either referred to in this report or are part of a fund's portfolio.