CITY OF LONDON
Investment Management Company Limited

International and Emerging Real Estate Semi-Annual Outlook

May 2020*

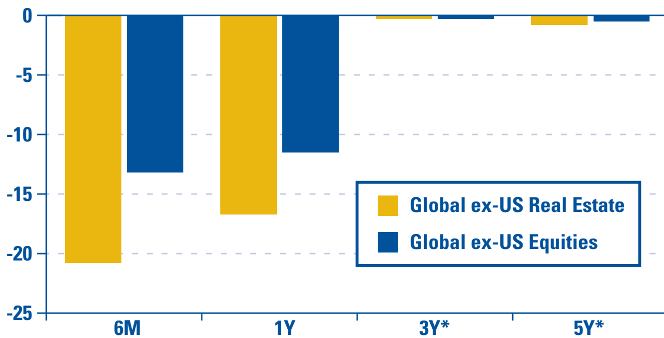
Overview

Navigating Out of the COVID-19 Storm

Health policies critically affect the likelihood of a second wave of COVID-19 and the prospect of economic recovery, which in turn drive consumer and business confidence and the outlook for real estate.

The COVID-19 pandemic has had a profound impact on the real estate sector. Hotels and retail real estate were hit first with international travel restrictions and quarantines. Lockdowns and social distancing then significantly dampened the usage of offices. Recessionary conditions have driven a sharp rise in the number of unemployed (e.g. the US) and furloughed workers (e.g. Europe), which in turn weigh on residential real estate. Excess deaths in nursing homes raise public concern about healthcare real estate. In comparison, industrial real estate is less impacted by social distancing, while investors are optimistic about data centres and infrastructure real estate as work from home arrangements and virtual meetings boost internet usage.

Chart 1: Historical Net Total Returns, %



**Annulized rate.*

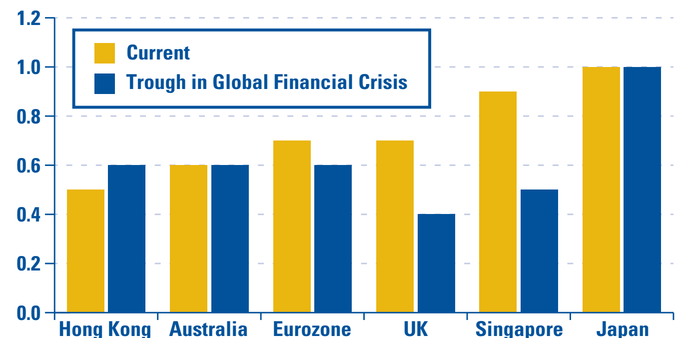
Source: FTSE EPRA/NAREIT Indices, MSCI Indices, Bloomberg as of April 30, 2020.

The year-to-date performance in different sectors largely reflects the effects of the pandemic. Hotels and retail real estate are the worst performers, whereas data centres and infrastructure real estate have delivered positive returns despite the global recession. In between are offices and healthcare real estate, and the pandemic has long-term ramifications for those assets. For instance, despite more employees working from home, social distancing may require employers to increase interpersonal space in the office, reversing the decade-long trend of shrinking square footage per capita.

Therefore, the real estate outlook depends on confidence (and fear), e.g. how many people are willing to return to offices and shopping malls, how many are willing to travel and stay in hotels, and how much they are able to spend. That, in turn, largely depends on the degree of success of public health and economic policy responses to COVID-19, which vary among countries. For instance, even though many countries have started to reopen, some may experience lacklustre confidence and private-sector spending for a relatively long period of time due to mistrust/confusion about government policies, job insecurity and/or fear about a second wave of infections. In other words, country differentiation matters in the post-COVID-19 era for real estate.

When it comes to public health response, developed Asian countries have drawn valuable lessons from their experience with SARS in 2003 and implemented stringent testing, contact tracing, isolation and quarantine at the early stage of the outbreak. As a result, they have largely avoided strict lockdowns and have been able to reopen their economies relatively early without risking a second wave of infections. The economic impact is less severe and consumer confidence may be rebuilt relatively quickly. Therefore, the hard-hit retail, offices and even hotels in the region may recover faster than those in other regions. That said, the region is sensitive to trade which is set to plunge sharply this year. Hence, export-related industrial real estate remains vulnerable.

Chart 2: Price-to-Book Ratios



Source: FTSE EPRA/NAREIT Indices, Bloomberg. Current as of May 11, 2020.

The economic policy response is equally crucial. Many governments are doing "whatever it takes" to mitigate the growth impact of the pandemic and lockdowns. Interest rate cuts, large-scale asset purchases and liquidity provision have driven down long-term

**The publication reflects asset performance up to 30 April, 2020, and macro events and data releases up to 11 May, 2020, unless indicated otherwise.*

interest rates to (or kept them at) historically low levels, supporting mortgages and residential real estate. Developed countries on average have launched larger fiscal and credit stimuli and household-income support schemes (via job retention or unemployment benefits) than EM countries as some of the latter are concerned about credit rating downgrades. DMs in general provide stronger support for household spending power and hence residential real estate than EMs do.

Allocation Breakdown

	-2	-1	0	+1	+2
Eurozone			■		
Japan				■	
UK	■				
Australia				■	
Hong Kong			■		
Singapore			■		
EM			■		

Source: City of London Investment Management

Market Strategy

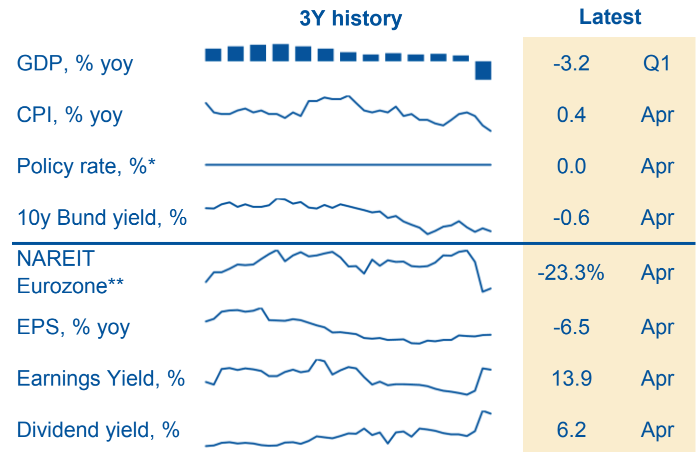
Public health and economic policy responses largely influence the pace and magnitude of the economic and real estate recovery which we stack against current valuations (Chart 2) to form our allocation recommendations. Valuations in Hong Kong, Japan and Australia look cheaper than, or close to, their respective troughs in the Global Financial Crisis (GFC). In contrast, the UK and Singapore look expensive relative to their previous lows in 2009. Therefore, our international and emerging market (EM) allocation recommendations are as follows:

- We are *overweight* **Australia and Japan** real estate on the back of the successful containment of the virus to date, substantial monetary easing and historically cheap real estate equity valuations.
- We are *underweight* **UK** real estate due to headwinds to the cautious economic recovery (e.g. difficult and complex negotiations with the European Union on their future relationship) and relatively unattractive valuations.
- We are *neutral* on **Hong Kong and Singapore** real estate. The cheapness in Hong Kong real estate reflects continued political uncertainty and its heavy reliance on tourism. Singapore real estate does not look attractively valued despite the country's successful containment of COVID-19.
- We are also *neutral* on **EM** real estate relative to developed counterparts. EMs are a diverse group in terms of the stage of the outbreak of each country and their respective policy response. For instance, while China is trying to contain a second wave of infections, Africa and Latin America have not yet seen the peak of the first wave. Intra-EM country differentiation is discussed in the second part of the report.

Eurozone

Neutral

The pandemic is set to knock a nascent recovery off course, but the policy response has been strong.



**ECB main refinancing rate*
***US$ net total return. Latest is 6M return.*
Source: Bloomberg

The economic backdrop prior to COVID-19 for Eurozone real estate was not dire: The Eurozone grew by 1.2% in 2019, around its growth potential. Domestic demand appeared more robust than its trade sector, with retail sales volume growing around 2.2%. Residential housing prices were growing above 4% per year, led by strong demand in Germany and France. When the virus began to spread, its impact differed significantly between Italy and Spain, for example, compared to Germany and Austria. In the former, the reaction was delayed and national health systems very close to being overwhelmed. In the latter, early and more comprehensive action (testing in particular) and a greater capacity to accommodate a surge in demand for health services led to a quicker slowdown in infections and lower fatalities.

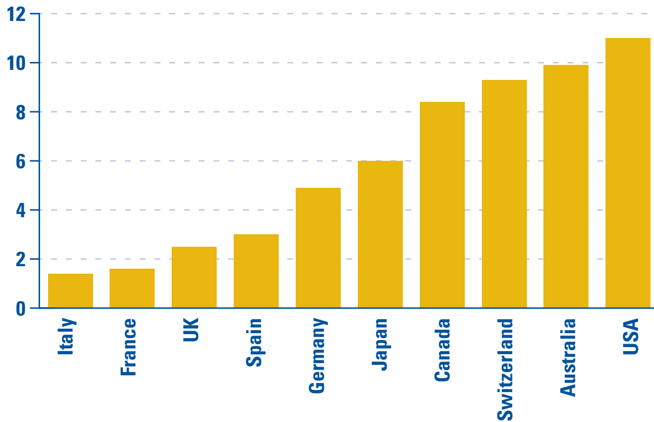
Q1 GDP tumbled by 3.8% from Q4 2019. The Composite PMI plunged to 13.6 in April, far below the 2009 trough. The IMF expected GDP to decline by 7.5% in 2020, the most severe contraction since the formation of the euro area. The ECB quickly stepped in to provide monetary support. It announced additional asset purchases of €120 billion until end-2020 under the existing QE program (APP), and temporary additional full-allotment liquidity auctions on more favourable terms (TLTRO-III). It later introduced a new liquidity facility, the Pandemic Emergency Longer-Term Refinancing Operations (PELTRO) at more advantageous rates and yet another asset purchase program of private and public sector securities (Pandemic Emergency Purchase Program, PEPP) worth at least €750 billion.

Like the health response, the fiscal response varied widely by country, partly reflecting different constraints and resources (Chart 3). As such, Germany was able to deploy over 4% of GDP worth of fiscal measures, while for Italy it was less than 2% of GDP

(excluding contingent liabilities in each case). At the European level, the room for manoeuvre is naturally constrained, but the EU provided a €540 bn package (4% of EU 27 GDP) to be administered through the ESM, the EIB and a new, temporary loan-based instrument (SURE). Heated discussions about mutually guaranteed pandemic debt issuance remained once more inconclusive.

Notably the eurozone unemployment rate only increased by 0.1% to 7.4% in March. This reflects the widespread adoption of short term work subsidies and furlough schemes. Those programs appear to have prevented a sharp rise in unemployment, which in turn supports consumer confidence and household spending during the lockdown. That said, it remains to be seen whether the approach is conducive to recovery once those temporary measures are lifted.

Chart 3: Fiscal Stimulus, % of GDP



Source: IMF

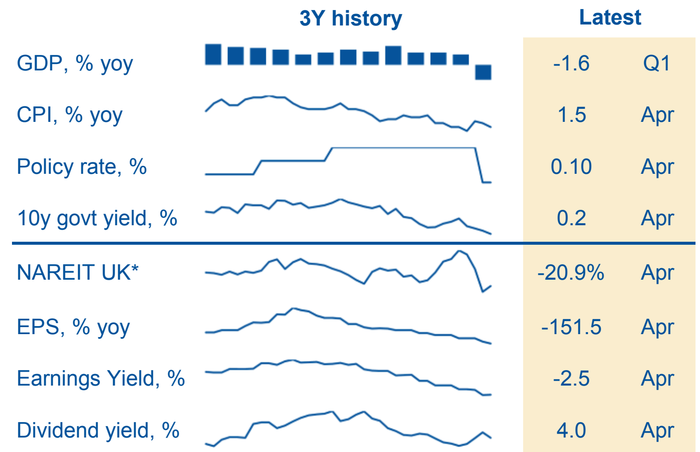
Market Strategy: The eurozone real estate sector is at a trailing P/B ratio of 0.7 times, a third cheaper than the long-term (15-year) average and slightly above the trough of 0.6 times in the GFC. The governments have been proactive with economic policy response.

That said, negative interest rates prior to the pandemic and the lack of a centralised fiscal authority also led to no rate cuts and modest direct fiscal support in certain Eurozone countries. Also, unlike developed Asian countries that have drawn valuable lessons from their dealing with 2003 SARS, COVID-19 seemed to have caught most European countries off-guard at least at the beginning, followed by a strict lockdown that dampened economic activity. Therefore, we are *neutral* on Eurozone real estate. Within Eurozone, industrial real estate may be less affected by lockdowns and social distancing measures than retail and hotel real estate. Wage subsidies and job retention schemes support household income and residential real estate. In contrast, an increasing number of people working from home may also weigh on demand for offices.

United Kingdom

Underweight

A weak economy ensnared in Brexit negotiations meets delayed health response to COVID-19.



	3Y history	Latest	
GDP, % yoy		-1.6	Q1
CPI, % yoy		1.5	Apr
Policy rate, %		0.10	Apr
10y govt yield, %		0.2	Apr
NAREIT UK*		-20.9%	Apr
EPS, % yoy		-151.5	Apr
Earnings Yield, %		-2.5	Apr
Dividend yield, %		4.0	Apr

**US$ net total return. Latest is 6M return.* *Source: Bloomberg*

The UK economy had been disappointing prior to COVID-19. Residential prices have decelerated from 8.4% growth yoy just before the Brexit referendum in 2016 to a mere 1.1% yoy this February. Retail sales volume has also been moderating for more than a year, weighing on retail real estate. The pandemic has then dragged the economy into a deep recession – the worst in 300 years according to the Bank of England. In common with some other countries which did not acknowledge the severity of the health threat at first, the UK was late in implementing containment measures (only following the first fatalities). It has one of the highest reported fatalities per million capita in the world.

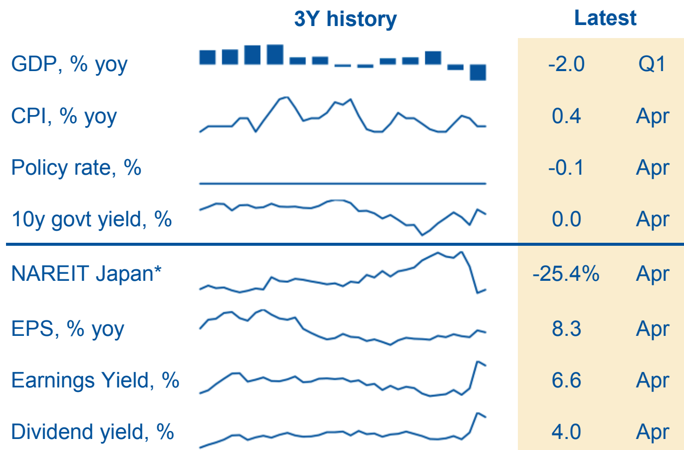
That said, economic policymakers have acted swiftly and decisively. The Bank of England (BoE) cut rates by 15bps to 0.1% in an emergency meeting ahead of the lockdown announcement and announced a new £200bn QE program, along with other funding facilities. More easing is expected. The government announced a comprehensive fiscal program including support for businesses, tax deferments, job retention schemes and benefits for vulnerable groups. Fiscal spending and tax cuts amount to 2.5% of GDP, though the whole package – including loans and guarantees - is as large as 20% of GDP. The IMF expects GDP to fall by 6.5% this year.

Market Strategy: The UK real estate sector is at a trailing P/B ratio of 0.7 times, cheaper than the long-term (15-year) average of 0.9 times but still significantly above the trough of 0.5 times in the GFC. The delayed health response in February led to a strict lockdown in March as well as a gradual reopening so as to avoid a second spike in infections. In addition, any recovery will be complicated by the ongoing task to finalise a Brexit agreement with the EU. Hence, we are *underweight*. Within the UK, we prefer industrial and self-storage real estate over the diversified and retail sectors.

Japan

Overweight

Economic and real estate activity was less affected by a soft lockdown, and parts of the economy have already reopened due to low infections.



	3Y history	Latest	
GDP, % yoy		-2.0	Q1
CPI, % yoy		0.4	Apr
Policy rate, %		-0.1	Apr
10y govt yield, %		0.0	Apr
NAREIT Japan*		-25.4%	Apr
EPS, % yoy		8.3	Apr
Earnings Yield, %		6.6	Apr
Dividend yield, %		4.0	Apr

***US$ net total return. Latest is 6M return.* *Source: Bloomberg*

Following the consumption tax hike and typhoons in 2019 (GDP contracted 7.1% qoq saar in Q4 2019), Japan's economy was on a weak footing prior to the pandemic. The delay of the Tokyo Summer Olympic Games will also take away an expected bounce in tourism, retail and catering.

That said, like other developed Asian economies, Japan managed to contain the spread of COVID-19 without imposing a strict lockdown like Europe. After slow action at the very beginning, PM Abe declared a nationwide state of emergency on April 16, expanding the coverage of the state of emergency to all Japanese prefectures from the seven announced on April 7. Soft lockdown was implemented with people voluntarily staying at home while factories remained open. This, together with stringent contract tracing, led to a low peak in fatalities and a decline in infections. 39 of the 47 prefectures have started to reopen since mid-May.

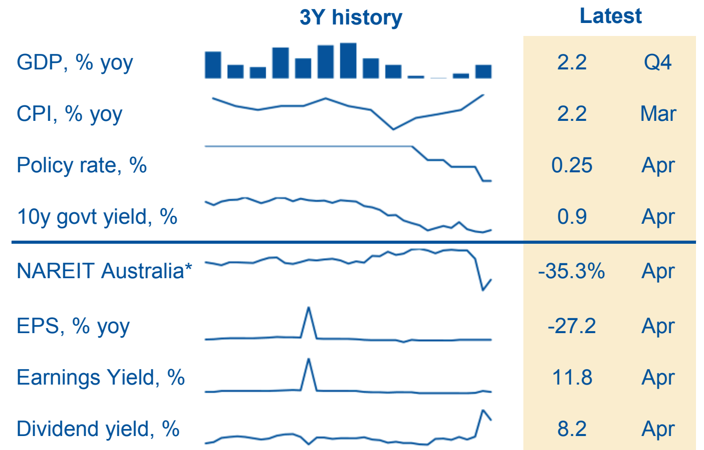
The Bank of Japan quadrupled its purchases in March of corporate debt, CP, ETFs and REITs as well as providing ample yen and dollar liquidity (extended further in April). The government adopted an Emergency Economic Package of ¥117.1 trillion (21% of GDP) and subsumed the remaining parts of previously announced packages in April. The key measures included cash handouts to individuals and firms, deferral of tax payments and social security contributions and support for concessional loans.

Market Strategy: The Japanese real estate sector is at a trailing P/B ratio of 1.0 times, 40% cheaper than its long-term (15-year) average and similar to the trough in the (GFC). Japan has contained the pandemic well so far and managed to reopen the economy relatively early thanks to stringent contact tracing and voluntary public compliance with social distancing. Without strict lockdowns, Japanese real estate should fare better than its European counterparts. We are *overweight*.

Australia

Overweight

Australia faces its first recession since 1991, but a strong policy response should help dampen the downturn.



	3Y history	Latest	
GDP, % yoy		2.2	Q4
CPI, % yoy		2.2	Mar
Policy rate, %		0.25	Apr
10y govt yield, %		0.9	Apr
NAREIT Australia*		-35.3%	Apr
EPS, % yoy		-27.2	Apr
Earnings Yield, %		11.8	Apr
Dividend yield, %		8.2	Apr

**US$ net total return. Latest is 6M return.* *Source: Bloomberg*

Australia's economy and housing market had been recovering amidst a series of interest rate cuts prior to COVID-19. However, the pandemic is set to push Australia into its first recession since 1991 when GDP fell by 1.1% yoy. Consensus now expects a 4.3% contraction in 2020, which would be the worst performance on record.

The policy response has been substantial, with the central bank (RBA) cutting its key rate by 50bps in March to a historical low of 0.25% and starting its first quantitative easing programme. It has also set up a term funding facility for lending to SMEs. Elsewhere, the financial regulator has removed capital requirements for banks for the duration of the COVID-19 crisis and banks are deferring loan repayments for small businesses impacted by the virus for six months. A fiscal stimulus amounting to 9.9% of GDP has also been announced, with the package including wage subsidies, income support for households, payroll tax relief and loan guarantees.

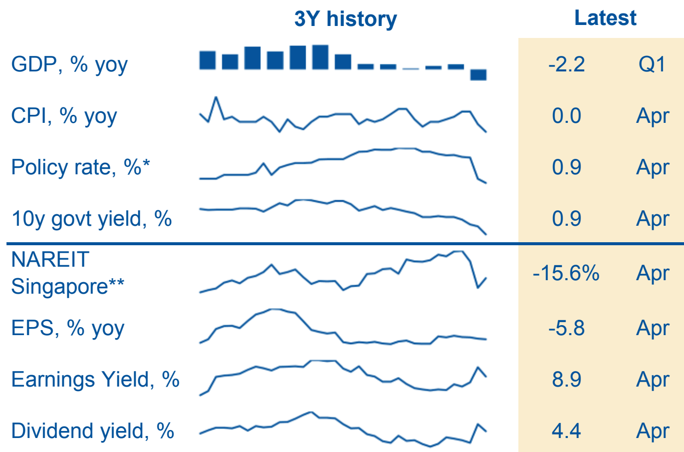
Testing for COVID-19 in Australia has been robust, with tests per million above even those of Germany. This, along with contract tracing and a lockdown starting in March, has helped to control the virus and allowed a gradual reopening of the economy.

Market Strategy: The Australian real estate sector is at a trailing P/B ratio of 0.6 times, almost half of its long-term (15-year) average and similar to the trough in the GFC. Real estate looks attractive in the historically-low-yield environment. Successful containment of the virus allows recovery in consumer confidence and the housing market. We are *overweight*. Within Australia, we are wary of retail real estate as Amazon continues to gain market share.

Singapore

Neutral

Having contained the domestic COVID-19 outbreak, Singapore braces for the global recession.



	3Y history	Latest	
GDP, % yoy		-2.2	Q1
CPI, % yoy		0.0	Apr
Policy rate, %*		0.9	Apr
10y govt yield, %		0.9	Apr
NAREIT Singapore**		-15.6%	Apr
EPS, % yoy		-5.8	Apr
Earnings Yield, %		8.9	Apr
Dividend yield, %		4.4	Apr

**3M interbank rate (SIBOR)*
***US$ net total return. Latest is 6M return.* *Source: Bloomberg*

Singapore has contained the domestic outbreak of COVID-19 well versus other countries in the region, due to its high-quality public health system, stringent contact tracing and strong public compliance with social distancing measures. Indeed, the country has one of the lowest case-fatality rates of 0.1% in the world. A relatively short period of lockdown also suggests that domestic activity will have been less affected by the pandemic than other countries.

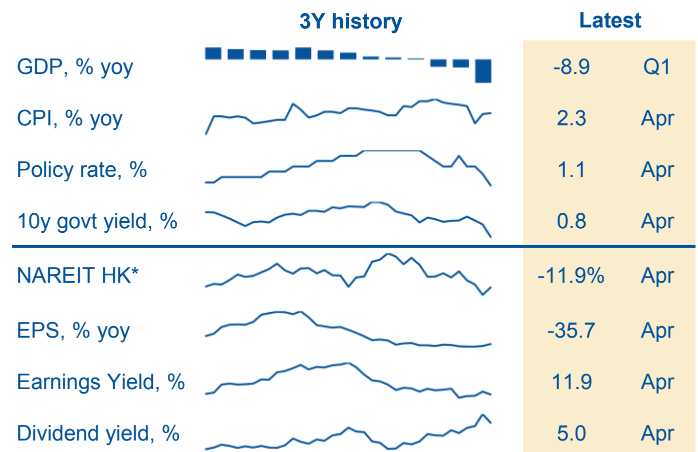
That said, as a small open economy Singapore is vulnerable to the global recession. Economic growth was already disappointing in 2019 due to the global slowdown and trade tensions, and GDP may contract by about 4% in 2020. Housing prices had been gradually recovering due to the fading of the tightening measures in 2018 but may weaken again amidst the COVID-19-induced economic decline. In response, the government launched several fiscal packages worth about 13% of GDP including cash payments to Singaporean citizens and wage subsidies for businesses. Monetary policy response is more modest with currency depreciation to mitigate the recession's impact on its export sector.

Market Strategy: The Singaporean real estate sector is at a trailing P/B ratio of 0.9 times, moderately cheaper than the long-term (15-year) average of 1.0 time but significantly more expensive than the trough of 0.5 times in the GFC. Its retail real estate may be less vulnerable than similar assets in other countries due to the country's successful containment of COVID-19. That said, the ASEAN region is hit hard by the pandemic which in turns weighs on office and industrial real estate in Singapore. Therefore, we are *neutral*.

Hong Kong

Neutral

Depressed real estate valuation reflects hard-hit retail and tourism activity.



	3Y history	Latest	
GDP, % yoy		-8.9	Q1
CPI, % yoy		2.3	Apr
Policy rate, %		1.1	Apr
10y govt yield, %		0.8	Apr
NAREIT HK*		-11.9%	Apr
EPS, % yoy		-35.7	Apr
Earnings Yield, %		11.9	Apr
Dividend yield, %		5.0	Apr

**US$ net total return. Latest is 6M return.* *Source: Bloomberg*

Hong Kong has drawn valuable lessons from SARS in 2003 and implemented stringent contact tracing, isolation and quarantine measures against the current pandemic. The public health system has also coped well, resulting in a very low case fatality rate of 0.4%.

That said, the economic backdrop had already been gloomy prior to the outbreak. In 2019, the city was experiencing its worst political crisis since the handover to China in 1997. Peaceful demonstrations against the Extradition Bill escalated into mass protests and violence, disrupting the local economy and sectors such as retail, catering, tourism and transportation. The pandemic threw another punch to those sectors as quarantine measures further deter tourists from coming to Hong Kong. The economy is set to contract by about 5% in 2020 following a 1.2% decline in 2019.

In response, the government launched fiscal stimulus worth about 10% of GDP including cash payment to permanent residents, wage subsidies and tax reliefs. The monetary authority also slashed the base rate from 1.5% to 0.5%. Substantial rate cuts and housing policies announced in Q4 2019 (e.g. relaxing of mortgage rules) have supported the housing market with the Centa-City Leading Index (a leading indicator of housing prices) declining by less than 2% so far this year.

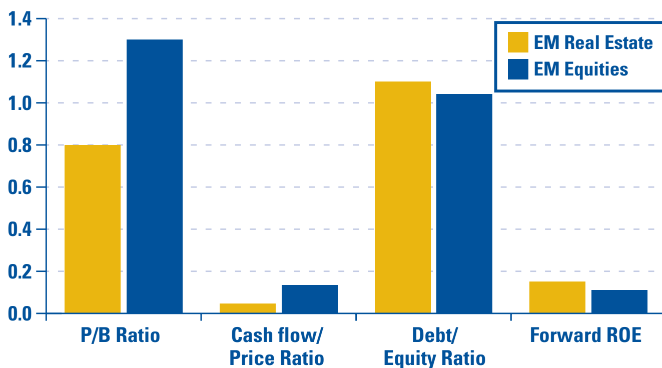
Market Strategy: FTSE EPRA/NAREIT Hong Kong, which includes a few Hong Kong-listed Chinese companies, has a trailing P/B ratio of 0.5 times, half of the long-term (15-year) average and cheaper than the previous trough of 0.6 times in the GFC. We are *neutral* on Hong Kong real estate as depressed valuations reflect the negative impact of political uncertainty and the pandemic on offices, retail and hotels. That said, residential real estate appears more resilient due to policy support.

Emerging Markets

EM real estate benefits from cheap valuations and a stronger return on equity, but has weaker cash flows than EM listed companies. The policy response is crucial to real estate revenues and the funding outlook.

EM real estate, as measured by FTSE EPRA NAREIT Emerging Index, is at a trailing P/B ratio of 0.8 times, significantly cheaper than the 1.3 times of EM equities (as measured by MSCI EM Index). And yet the forward ROE of EM real estate of 15% is much stronger than the 11% EM equities offer (Chart 4). Is EM real estate thus attractive given its cheap valuations and a strong ROE?

Chart 4: Price and Financial Ratios



Source: FTSE EPRA/NAREIT Indices, MSCI Indices, Bloomberg

We would suggest so, but only for the real estate companies without serious cash flow problems in this challenging environment. EM real estate has slightly higher debt leverage than EM equities (110% vs. 104%) and the former's trailing cash flow yield is only 4.6%, a third of the latter. That suggests a weaker liquidity and solvency profile for EM real estate. The severe recession in many countries suggests much weaker (or even negative) cash flows for many EM real estate companies in the short term through either loss of revenue or loss of funding.

Country differentiation matters for selecting EM real estate companies in this environment. First, unlike developed countries that have contained the first wave of infections, EM countries are at different stages of the outbreak. While China is trying to contain a second wave of infections, Africa and Latin America have yet to see the peak of daily infections in the first wave. Lockdowns are implemented in most EMs amidst high infection numbers, resulting in a suspension of the real estate market (e.g. few to no real estate transactions) and a loss of revenue for real estate companies.

Second, global risk aversion and capital outflows penalise countries with a weak fiscal profile. Certain EMs (e.g. Mexico, Indonesia and South Africa) have seen a rise in borrowing costs despite their central banks' significant monetary and liquidity easing. That, in turn, negatively affects real estate companies' ability to source funding.

Third, government support largely influences the pace and magnitude of any post-pandemic recovery in the economy and the real estate sector. Due to weak fiscal profiles or fractious politics, some countries are slow to launch substantial fiscal stimuli to support households and businesses, which again weighs on residential, retail and office real estate.

Therefore, we are selective within the EM real estate space even though many EM real estate equities have cheapened to historically low levels. In general, we prefer countries with effective public health and economic policy responses to COVID-19, necessary conditions for an early and rapid economic recovery.

EM Allocation Breakdown

	Chg	-2	-1	0	+1	+2
China	↓		■			
Philippines	–				■	
Thailand	↑			■		
Malaysia	↑				■	
Indonesia	–			■		
Brazil	–			■		
Mexico	↓		■			
South Africa	–			■		

Note: Up/down arrows indicate a positive/negative change in our asset allocation compared to the previous quarter. A dash indicates no change.

Source: City of London Investment Management

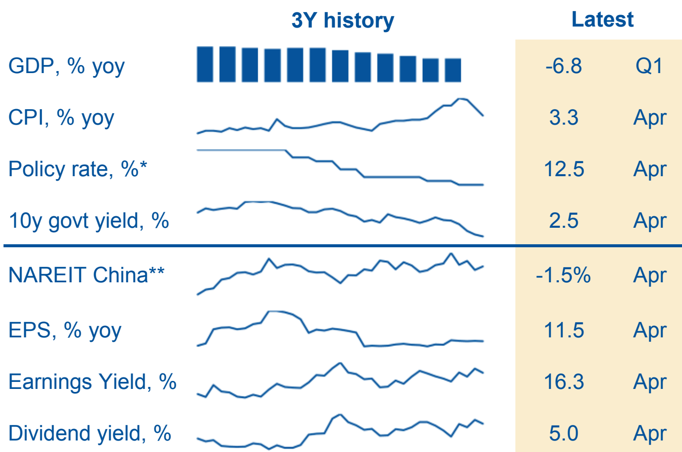
We thus recommend the following country allocation within EMs:

- We are *overweight* the **Philippines** given its likely positive economic growth this year (rare in the world) which supports both residential and retail real estate.
- We upgrade **Malaysia** to *overweight* and **Thailand** to *neutral* as both economies gradually reopen following effective public health responses that have contained COVID-19. Fiscal stimulus also supports household income and retail real estate.
- We downgrade **China** and **Mexico** to *underweight* as the current valuations do not fully reflect the negative impact of a severe global recession.
- We remain *neutral* on **Indonesia**, **Brazil** and **South Africa** despite cheap valuations of their real estate companies. A slow public health response in Indonesia, increasingly fractious politics in Brazil and limited fiscal support in South Africa negatively affect business and consumer confidence in those countries, weighing on their real estate sectors.

China

Underweight vs EM (↓)

China is vulnerable to a global recession despite its success in containing the disease. Policy stimulus largely bypasses residential real estate.



**Required Deposit Reserve Ratio for Major Banks*
***US$ net total return. Latest is 6M return.* *Source: Bloomberg*

China was the first country to catch COVID-19 and the first to have contained it domestically with large-scale isolation and quarantine measures. Significant policy support has been put in place since the outbreak, and more is expected to come as China braces for a global recession. As early as February, the central bank (PBoC) deployed unconventional measures such as re-lending and re-discounting facilities of RMB 1.8trn ($256 bn), followed by a liquidity injection of at least RMB 3trn ($427 bn) into the banking sector as well as various policy rate cuts. The Ministry of Finance has also stepped up fiscal spending, tax reliefs, local-government bond issuance and infrastructure investment (e.g. 5G and urban transport).

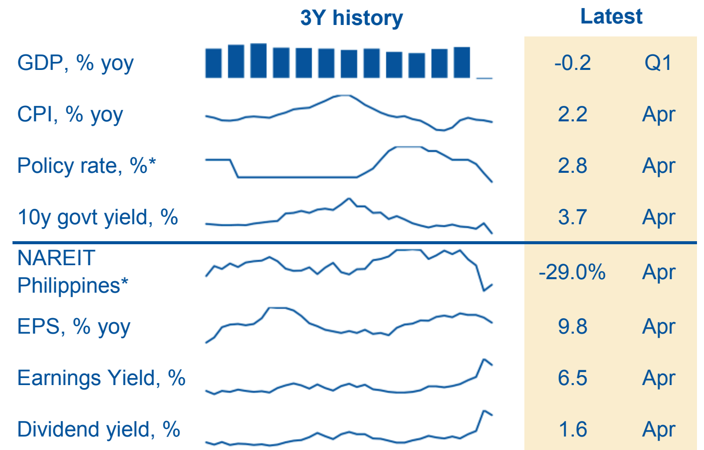
That said, the monetary, credit and fiscal easing this time looks different from that seen in 2008/09 and 2015/16 for three reasons. First, the decline in global demand in 2020 will be more severe than previously. Policy stimulus may at best help boost Chinese economic growth to around potential in H2 2020 as opposed to above it, as was the case in 2008/09 and 2015/16. Second, easing is more targeted and calibrated towards COVID-19-affected sectors this time, and hence broad credit growth is unlikely to jump as substantially as in the previous two episodes. Third, residential real estate has become the least favourite channel of easing due to concerns about housing affordability and financial instability. All in all, consensus expects GDP growth to fall to 1-2% this year from 6.1% in 2019, the biggest annual drop since the GFC.

Market Strategy: We downgrade China to *underweight* vs EMs. The real estate sector is at a trailing P/B ratio of 0.9 times, similar to its 10-year average and 28% above the trough. Despite its success in containing the virus, China is vulnerable to a global recession. Policy stimulus, while substantial, largely bypasses residential real estate.

Philippines

Overweight vs EM

A sharp slowdown could be cushioned in H2 by infrastructure buildout.



**US$ net total return. Latest is 6M return.* *Source: Bloomberg*

The Philippine housing market had been buoyant with house prices growing by more than 10% in 2019, and the whole economy had a strong growth outlook going into 2020. However, uncertainty began to rise in January when President Duterte and, significantly, his administration spoke of renegotiating government contracts with a broad range of private sector companies. The outlook was then severely hit by COVID-19 with a partial lockdown of the country and the weak external backdrop. The IMF's forecast stands at 0.6%, a positive number despite expected global growth contraction.

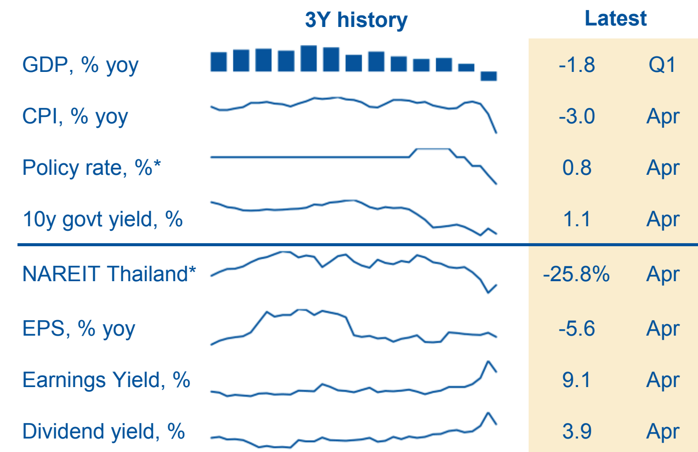
BSP has aggressively cut its key policy rate by 125bps this year to 2.75% and reduced the RRR for banks by 200bps. It also announced its first quantitative easing programme, worth PHP 300bn ($6bn) and equivalent to around 1.5% of GDP. Fiscal stimulus has been modest so far (1.1% of GDP) targeting agriculture, tourism, SMEs and low-income households. This will help cushion the economic downside from COVID-19, while plans to speed up infrastructure buildout could provide a boost in H2. Health measures to contain the virus have been good with the government putting certain high-risk areas under an "enhanced community quarantine" (ECQ). Other containment and mitigation measures include suspension of flights from high-risk economies, restrictions on mass gathering, and school closures.

Market Strategy: The Philippine real estate sector is at a trailing P/B ratio of 1.8 times, the lowest in 9 years and 25% below its 10-year average. We remain *overweight* the Philippines vs EMs given its expected positive GDP growth this year (a standout compared to the rest of the world), aggressive monetary easing and cheap valuations. That said, we avoid office real estate vulnerable to China's clampdown on offshore gaming

Thailand

Neutral vs EM (↑)

The fall of tourism hits hotel and retail real estate but other sectors are supported by substantial stimulus.



**US$ net total return. Latest is 6M return.* *Source: Bloomberg*

House price growth in Thailand had been stable at around 5% per annum until the virus outbreak. The trade-and tourism-dependent economy is forecast to contract by 5.3% in 2020 according to the Bank of Thailand (BoT). As a result, BoT eased policy, cutting its key rate by 50bps to 0.75% with more easing expected. It eased liquidity pressures by providing low-interest loans to financial institutions and SMEs as well as relaxing debt repayment conditions. The Bank has also taken unprecedented steps and established facilities to purchase up to THB 400 billion of corporate bonds and at least THB 100 billion of government bonds in the market. The Cabinet has also launched strong fiscal stimulus amounting to at least 8.9% of GDP including health spending, wage subsidies, tax reliefs and utility bill reduction.

Thailand announced a state of emergency towards the end of March with travel restrictions and a national curfew. These measures have led to a decline in daily reported infections and an easing of lockdown starting early May.

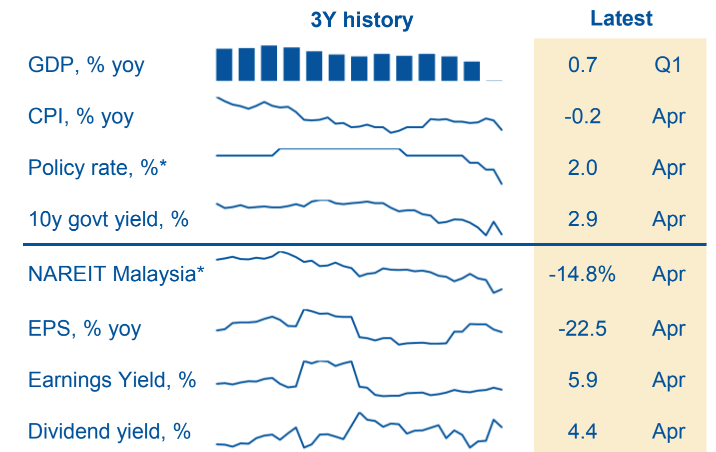
Market Strategy: We upgrade Thai real estate to *neutral* vs other EMs. The real estate sector is at a trailing P/B ratio of 1.3 times, the cheapest since records started in 2011 and 43% below the long-term average. Policymakers have been able to launch unprecedented monetary, liquidity, credit and fiscal easing – without denting the monetary and fiscal authorities' credibility – on the back of large foreign exchange reserves, many years of current account surplus and low government debt. Indeed, disorderly capital outflows and currency devaluation have been avoided so far. 10-year government bond yields have been stable just above 1%.

Retail real estate may suffer due to the hit of COVID-19 on the tourism industry. That said, residential real estate and household income may be supported by the unprecedented monetary and fiscal support.

Malaysia

Overweight vs EM (↑)

The economy is likely to slip into recession, but the strong policy response is set to limit the downside.



**US$ net total return. Latest is 6M return.* *Source: Bloomberg*

Malaysia's economy and its housing market were decelerating prior to the outbreak of COVID-19 and now face a recession in 2020. The fall in global trade as a result of various lockdowns along the supply chain will likely be a significant drag for its open economy. Household consumption (57% of GDP) is also set to contract. The IMF estimate is for a 1.7% yoy GDP contraction in 2020, which would match that experienced during the GFC.

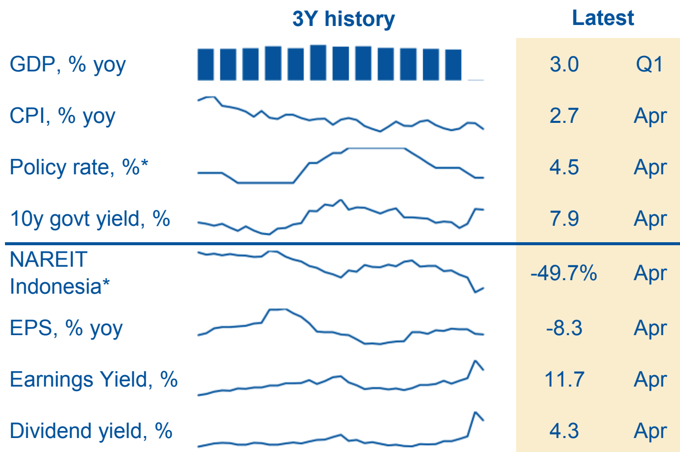
Monetary and fiscal stimuli have been significant, which should cushion the blow from the virus. BNM cut its key policy rate by 100bps to 2.0%, as low as it was during the GFC. BNM has attempted to ease liquidity concerns, too. The Bank lowered the statutory reserve requirement from 3% to 2%, which will allow banks to have a liquidity coverage ratio below 100% and declared a six-month moratorium on all bank loans. The government has announced three rounds of fiscal packages worth 2.8% of GDP. They were mainly aimed at support for SMEs and welfare programmes, including cash handouts, rent exemptions and reduced energy prices. A nationwide lockdown has been implemented since March and has helped contain the spread of COVID-19. Daily reported infections peaked at the end of March and have declined since then.

Market Strategy: We upgrade Malaysian real estate to *overweight* vs other EMs. The real estate sector is at a trailing P/B ratio of 0.5 times, the cheapest since records started in 2013 and half the long-term average. Both residential and retail real estate suffer against the backdrop of COVID-19. However, Malaysia seems to have contained the spread of the virus quicker than many other countries in the region meaning it could ease the lockdown and possibly normalise the economic activity earlier. Monetary, fiscal and liquidity measures will also support the recovery.

Indonesia

Neutral vs EM

Cheap real estate equity valuations reflect a relatively modest fiscal and public health response to COVID-19.



	3Y history	Latest	
GDP, % yoy		3.0	Q1
CPI, % yoy		2.7	Apr
Policy rate, %*		4.5	Apr
10y govt yield, %		7.9	Apr
NAREIT Indonesia*		-49.7%	Apr
EPS, % yoy		-8.3	Apr
Earnings Yield, %		11.7	Apr
Dividend yield, %		4.3	Apr

**US$ net total return. Latest is 6M return.* *Source: Bloomberg*

Indonesia's already weak economy and housing market took another hit as a result of the pandemic. Retail sales had been stagnating at the beginning of the year before contracting by 5.3% yoy in March. House prices are declining in real terms. Domestic demand and credit growth continue to slide despite monetary easing, liquidity injections and the central bank's intervention to stabilise the bond and FX markets.

Economic imbalances and the relatively muted policy response to COVID-19 delay the containment of the virus and the subsequent economic recovery. Persistent current account and fiscal deficits as well as small domestic savings mean that the economy relies on external financing. That, in turn, had prevented the government from borrowing substantially in the market and slowed its fiscal response. The fiscal package amounting to 2.6% of GDP wasn't announced until March 31, later than many other countries in Asia. Capital outflows have led to a rise of nearly 100bps in 10-year government bond yields despite the 50bps interest rate cut, further limiting fiscal space.

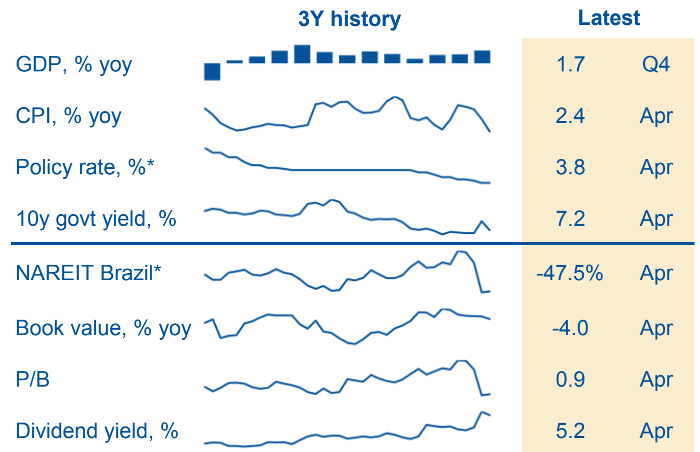
Meanwhile, the public health response has been slow to contain the spread of the disease as well. Indonesia has the highest case fatality rate (above 7%) among the major ASEAN countries, suggesting a poor medical system and inadequate antigen testing amongst its 264mn population.

Market Strategy: The Indonesian real estate sector is at a trailing P/B ratio of 0.6 times, the cheapest since the data started in 2013 and 60% below the long-term average. However, both residential and retail real estate will suffer from the government's relatively slow economic and public health response to COVID-19, which in turn delays the subsequent economic recovery. Therefore, we remain *neutral* on Indonesian real estate.

Brazil

Neutral vs EM

Brazil is ill-placed to weather the spread of the virus. Increasingly fractious politics limit reform hopes.



	3Y history	Latest	
GDP, % yoy		1.7	Q4
CPI, % yoy		2.4	Apr
Policy rate, %*		3.8	Apr
10y govt yield, %		7.2	Apr
NAREIT Brazil*		-47.5%	Apr
Book value, % yoy		-4.0	Apr
P/B		0.9	Apr
Dividend yield, %		5.2	Apr

**US$ net total return. Latest is 6M return.* *Source: Bloomberg*

Brazil has been slow in accepting the severity of the health crisis, with President Bolsonaro repeatedly dismissing the threat, mocking opponents and mingling deliberately in large groups of people. As a result, several former allies have broken with Bolsonaro and introduced their own regional lockdowns. That, plus the resignation of hugely-popular justice minister Sergio Moro, suggests increasingly fractious politics and limits any hope of additional meaningful reform this year.

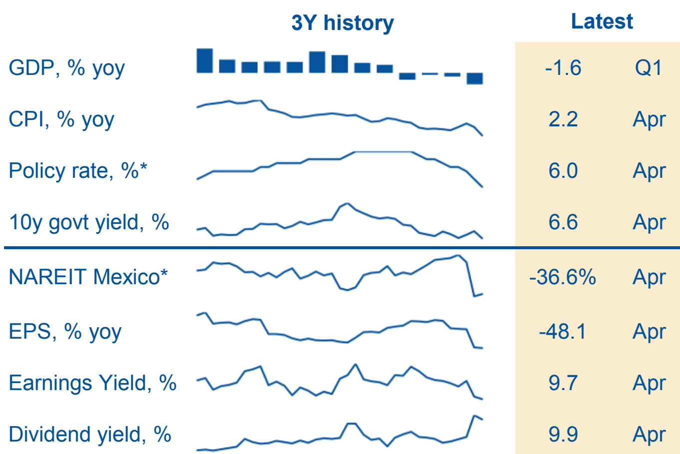
The central bank (BCB) aggressively cut the Selic rate by 125bps to 3.0% so far this year and announced liquidity injections worth up to Brl1.2 trn. It also intervened heavily in the FX market in support of the real, the worst-performing EM currency year-to-date. The government also announced a series of fiscal measures such as early payments of social benefits, the deferral of tax payments, an increase in social spending and the provision of credit lines to firms to protect employment. The primary deficit is likely to expand by 3.5% of GDP this year. The remaining fiscal space looks limited given the already high fiscal debt and deficit as well as decade-low oil prices. Despite policy support, the IMF expects the economy to contract by 5.3% this year, the worst in at least 25 years.

Market Strategy: The Brazilian real estate sector is at a trailing P/B ratio of 0.7 times, 30% cheaper than its long-term average since 2013 and 70% above the trough in 2015. House prices had been stagnating prior to the pandemic. Both residential and retail real estate are set to take a hit amidst the serious recession. Inadequate public health response, increasingly fractious politics and limited reform prospect may delay and slow the post-pandemic economic recovery. We remain *neutral* on Brazil vs EMs.

Mexico

Underweight vs EM (↓)

The economy will go from recession to recession after their delayed response to the pandemic, which will weigh on residential and retail real estate.



	3Y history	Latest	
GDP, % yoy		-1.6	Q1
CPI, % yoy		2.2	Apr
Policy rate, %*		6.0	Apr
10y govt yield, %		6.6	Apr
NAREIT Mexico*		-36.6%	Apr
EPS, % yoy		-48.1	Apr
Earnings Yield, %		9.7	Apr
Dividend yield, %		9.9	Apr

**US$ net total return. Latest is 6M return.* *Source: Bloomberg*

The Mexican economy had already been in recession before COVID-19. President AMLO's interventionist business policies had resulted in a decline in fixed-asset investment, though private consumption and retail activity were held up relatively well. The pandemic and low oil prices have put the economy and the retail sector under great strain. The IMF expects GDP to contract by 6.6% in 2020, similar to the Tequila crisis in 1994/95.

In parallel with his Brazilian counterpart, AMLO has been in acute denial of the severity of COVID-19, dismissing all warnings and urging the population to carry on life as normal. AMLO belatedly announced a set of piecemeal distancing measures. Daily infections were still rising in Mexico when most EM countries had seen the peak.

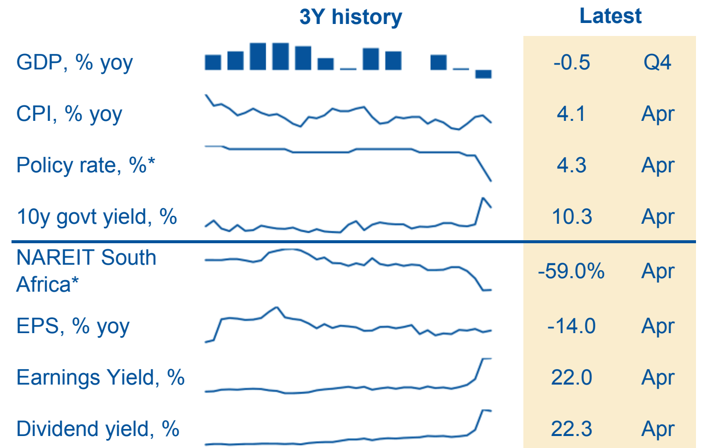
The President announced a series of lacklustre initiatives – less than 2% of GDP - to dampen the economic fallout of the health crisis, including increased social transfers, subsidies and credit for SMEs. However, the emphasis remains on the pre-existing plans to boost infrastructure spending. These initiatives are widely deemed to be insufficient to forestall a deep recession. A large fiscal deficit, low oil prices and falling external demand are likely to trigger a credit ratings downgrade. Banco de Mexico has cut its reference rate by 100bps to 6.0% so far this year. The room for further monetary easing is limited given the weak currency and Mexico's precarious investment-grade status.

Market Strategy: The Mexican real estate sector is at a trailing P/B ratio of 0.5 times, above the trough of 0.3 times in 2012. COVID-19 has weighed on office and retail real estate. Business-unfriendly policies, limited fiscal stimulus and belated health measures are likely to delay and suppress the post-pandemic economic recovery. Therefore, we downgrade Mexico to *underweight* vs EMs. Industrial real estate is also vulnerable to the US recession.

South Africa

Neutral vs EM

A sharp fall in activity and a credit rating downgrade contrast with a strong health response to COVID-19.



	3Y history	Latest	
GDP, % yoy		-0.5	Q4
CPI, % yoy		4.1	Apr
Policy rate, %*		4.3	Apr
10y govt yield, %		10.3	Apr
NAREIT South Africa*		-59.0%	Apr
EPS, % yoy		-14.0	Apr
Earnings Yield, %		22.0	Apr
Dividend yield, %		22.3	Apr

**US$ net total return. Latest is 6M return.* *Source: Bloomberg*

South Africa faced anaemic growth prospects in 2020 prior to the onset of COVID-19, which is set to tip the country into a deep recession. The IMF expects the GDP to decline by 5.8% this year, the worst fall on record. This has led the central bank (SARB) to cut its key policy rate by 225bps this year to 4.25% and more rate cuts are likely. The SARB has also started its first quantitative easing program and purchased government bonds in the market.

Despite central bank easing, global risk aversion pushed up 10-year government bond yields by as much as 350bps before falling and are still about 80bps above its pre-pandemic level. It constrains fiscal space and so far fiscal measures are less than 1% of GDP. South Africa's foreign currency debt rating was downgraded to non-investment grade (Ba1) by Moody's in March and hence all three major rating agencies have now assigned the country a sub-investment grade rating.

A nationwide lockdown is also in place to contain the increasing spread of COVID-19. South Africa has a young population with only 5% over 65, potentially making it less vulnerable to the disease. Testing for the virus has gone up markedly and this should help guide policies to contain the virus. Indeed, the case-fatality rate has stayed under 2%, among the lowest in Africa.

Market Strategy: The South African real estate sector is at a trailing P/B ratio of 0.3 times, the cheapest since the data became available in 2013 and 70% below the long-term average. The extreme cheapness reflects the spreading disease, serious economic contraction, depressed retail activity and excess supply in the sector. Therefore, we remain *neutral*.

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KEY ECONOMIC AND FINANCIAL INDICATORS *(All data shown are as at May 18, 2020 unless otherwise stated)*

		Macroeconomic Data													Market Performance and Forecast					
		% change on year ago																		
		Annual Real GDP	Quarterly Real GDP QoQ*	Industrial Production	Consumer Price Index	Broad Money (M2/M3) ***	Budget Balance % of GDP 2020F**	Current Account Balance	Unemployment Rate	Currency vs $ 2020 Latest	Currency vs $ 2019 Year ago	Short-Term Interest Rates	10-Year Government Bond Yield	Sovereign Rating S&P	% FTSE EPRA/NAREIT EM Capped Index	Stock Market (FTSE EPRA/ NAREIT) US$	Change since 12/31/2019 US$	Change since 12/31/2019 Local	Dividend Yield	2020 P/E Forecast**
		%	%	%	%	%		$ Bn	%			%	%		Apr. 30, 2020	May 18, 2020	%	%	%	
Overweight	MALAYSIA	0.7	-8.0	-4.9	-0.2	3.7	-4.9	10.3	3.3	4.3	4.2	1.9	2.9	A-	5.61	1354.31	-26.2	-21.3	4.5	14.8
	PHILIPPINES	-0.2	n.a.	-6.3	2.2	10.9	-5.9	-0.5	5.3	50.7	52.6	3.7	3.3	BBB+	19.27	4958.44	-32.1	-32.0	1.9	15.8
Neutral	BRAZIL	1.7	2.0	-3.8	2.4	12.4	-11.5	-49.7	12.2	5.7	4.1	2.8	7.2	BB-	10.64	676.85	-62.1	-46.0	2.7	21.2
	CHILE	0.4	12.1	0.8	3.4	10.2	-7.1	-10.0	7.8	819.7	697.0	1.9	n.a.	A+	2.20	3131.73	-32.4	-26.2	2.2	20.6
	INDIA	4.7	6.4	-16.7	5.8	10.7	-4.0	-26.9	n.a.	75.6	69.8	5.7	5.8	BBB-	4.21	495.78	-41.4	-37.7	3.1	13.1
	INDONESIA	3.0	-9.6	-0.8	2.7	6.4	-5.1	-30.4	5.0	14739.0	14472.0	5.5	7.6	BBB	3.10	779.73	-48.4	-44.9	4.7	8.8
	KUWAIT	-3.5	-1.0	n.a.	1.9	-2.4	-6.6	20.3	n.a.	0.3	0.3	2.7	n.a.	AA-	1.65	n.a.	n.a.	n.a.	n.a.	n.a.
	RUSSIA	1.6	-9.6	0.3	3.1	13.4	-3.9	52.8	4.7	72.5	64.5	5.3	5.5	BBB-	0.42	2512.12	n.a.	n.a.	1.1	64.7
	SOUTH AFRICA	-0.5	-1.4	-2.1	4.1	10.9	-11.3	-42.3	29.1	18.3	14.4	4.9	9.2	BB-	6.96	906.20	-64.4	-53.2	17.5	5.1
	THAILAND	-1.8	-8.8	-11.2	-3.0	7.2	-3.0	35.0	1.0	31.9	31.9	0.8	1.1	BBB+	9.80	6702.72	-26.0	-20.4	3.1	16.3
	TURKEY	3.1	7.8	-2.0	10.9	17.0	-6.1	1.5	13.7	6.8	6.0	14.1	13.2	B+	0.93	519.34	-22.2	-10.0	n.a.	n.a.
	UAE	1.7	n.a.	n.a.	-1.4	4.6	-6.4	29.6	n.a.	3.7	3.7	0.8	n.a.	n.a.	1.95	2340.83	-40.8	-40.8	n.a.	6.3
Underweight	CHINA	-6.8	-39.2	3.9	3.3	11.1	-6.3	81.6	3.6	7.1	6.9	1.1	2.7	A+	19.73	5371.66	-18.7	-17.0	6.1	5.6
	MEXICO	-1.6	-6.2	-5.0	2.2	11.4	-4.3	-26.5	2.9	23.6	19.1	5.6	6.1	BBB	9.31	86.39	-38.7	-23.2	9.4	6.9
	USA	0.3	-4.8	-15.0	0.3	8.0	-15.5	-498.4	14.7	1.0	1.0	0.6	0.7	AA+	n.a.	4936.84	-27.4	-27.4	5.0	36.3

*Note: S&P credit rating shown is long-term foreign currency rating. * % change in GDP on previous quarter, annual rate. **Bloomberg consensus forecast. ***M3 is used. M2 is used if M3 is unavailable.*
Any forecasts are based on Bloomberg consensus forecasts, where available, and assumptions. Actual results may vary from any such statements or forecasts. Past performance is no guarantee of future results.
Source: Bloomberg, City of London Investment Management

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		%	%	%	%	%		$ Bn	%			%	%		Apr. 30, 2020	May 18, 2020	%	%	%	
Overweight	AUSTRALIA	2.2	2.0	2.5	2.2	4.4	-5.3	7.0	6.2	0.7	0.7	0.9	1.0	AAA	5.21	2296.71	-39.7	-34.9	7.1	11.5
Overweight	JAPAN	-2.0	-3.6	-5.2	0.4	3.0	-8.0	182.3	2.5	107.9	110.0	0.0	0.0	A+	20.19	3157.20	-25.0	-25.9	3.8	15.1
Neutral	CANADA	2.1	0.3	-1.1	0.9	10.2	-6.1	-34.4	13.0	1.4	1.3	0.4	0.6	AAA	4.65	5412.23	-34.7	-29.7	6.3	21.5
Neutral	EMERGING MARKETS	-4.6	n.a.	-7.0	4.5	n.a.	-6.1	6.0	5.0	1567.0	1611.9	4.4	3.0	n.a.	21.26	2657.30	-27.6	-27.6	5.5	6.7
Neutral	EUROZONE	-3.2	-15.2	-12.9	0.4	7.5	-9.2	377.0	7.4	1.1	1.1	0.1	-0.0	n.a.	15.88	2298.79	-26.2	-24.0	6.2	12.7
Neutral	HONG KONG	-8.9	-21.2	-0.5	2.3	0.0	-4.8	51.9	5.2	7.8	7.8	0.9	0.8	AA+	11.67	3103.32	-17.3	-17.7	5.4	10.6
Neutral	SINGAPORE	-2.2	-10.6	16.5	0.0	6.9	-2.9	63.3	2.4	1.4	1.4	0.5	0.7	AAA	5.53	2901.15	-20.1	-15.6	5.2	17.9
Neutral	SWEDEN	-0.4	0.8	-0.2	-0.4	12.8	-4.6	20.7	6.7	9.7	9.7	0.2	0.0	AAA	3.28	15648.55	-30.1	-27.3	3.1	15.7
U/W	UK	-1.6	-8.0	-8.2	1.5	3.2	-10.5	-106.9	3.9	1.2	1.3	0.2	0.2	AA	8.20	1052.16	-35.3	-29.6	3.8	20.8
U/W	USA	0.3	-4.8	-15.0	0.3	8.0	-15.5	-498.4	14.7	1.0	1.0	0.6	0.7	AA+	n.a.	4936.84	-27.4	-27.4	5.0	36.3

*Note: S&P credit rating shown is long-term foreign currency rating. * % change in GDP on previous quarter, annual rate. **Bloomberg consensus forecast. ***M3 is used. M2 is used if M3 is unavailable. Any forecasts are based on Bloomberg consensus forecasts, where available, and assumptions. Actual results may vary from any such statements or forecasts. Past performance is no guarantee of future results.*

Source: Bloomberg, City of London Investment Management

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