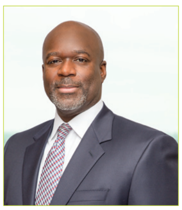
Starlight™ Capital

STARLIGHT GLOBAL REAL ESTATE FUND

Global real estate up 6.1%[1] in Q3, outperforming global and U.S. equities



Dennis Mitchell, MBA, CFA, CBV
CEO & CIO

Michelle Wearing, CA, CPA, CBV
Associate Portfolio Manager,
Real Estate

Key takeaways

- Year-to-date global real estate equities have generated a 17.3%[2] total return
- Canadian real estate leads the way with DREAM Global REIT up 22.8%[3] and Minto Apartment REIT up 20.8%[3]
- Global real estate equities were up 6.1%[1] in Q3

Macroeconomic update

Since the start of the year, investors have pointed to a series of issues that might lead the global economy towards a recession. Q4 2018 saw global equity markets sell off as investors grew concerned that the Federal Reserve Bank would raise rates four times in 2019 and tip the U.S. economy into recession. This was followed by concerns that Brexit and the U.S./China trade war would combine to push the three largest economic zones into recession. Then during the summer, yield curve inversions stoked investors' fears that a global recession was imminent. Finally, economic data, including recent Purchasing Managers' Index (PMI) readings, have made investors fear that future economic output was due to contract as manufacturing activity continued to decline.

In response to these macroeconomic risks, central banks have leaned heavily into monetary accommodation. As a result, global yield curves have flattened significantly and the amount of sovereign debt trading at negative yields has increased sharply. While we do not expect global growth to accelerate anytime soon, we do think the global economy is stabilizing at a level of growth that is below the prior long-term trend rate (3.8% since 1950) but in-line with the more recent average since 2008. We expect that synchronized global easing by central banks will eventually cause leading economic indicators to rise, followed by improving PMIs, global economic output and finally equities.

In response to market volatility and economic uncertainty, investors have gravitated to firms with better growth potential, fundamental and operating momentum and/or low volatility/defensive characteristics. Capital has been allocated to global real estate securities, causing their trading multiples to rise and boosting total returns.

[1] From June 28, 2019 to September 30, 2019. Global real estate is represented by FTSE EPRA NAREIT DEVELOPED Total Return Index (CAD). [2] From December 31, 2018 to September 30, 2019. Source: Bloomberg LP. Global real estate is represented by FTSE EPRA NAREIT DEVELOPED Total Return Index (CAD). [3] From June 28, 2019 to September 30, 2019. Source: Bloomberg LP.

Consensus estimates for 2019 S&P 500 EPS growth are now 2.1%, which is down from 2.6% in Q2. Q3 2019 is anticipated to be the trough quarter at -2.2%. Building off the poor finish to last year, Q4 EPS growth should rebound to 4.1%. 2020 consensus EPS growth currently sits at 10.1% but with anticipated downward revisions, 2020 is likely to see 5.0% EPS growth[4]. The 2020E price-to-earnings (P/E) multiple for the S&P 500 has risen to 17.1x and the current dividend yield is 2.0%. High single digit total returns from this point would seem to be in order, but with a continued uptick in market volatility[5].

In Q3, the PMI Composite declined from 52.1 to the current reading of 51.3[6]. Manufacturing and Services were both flat in Q3 at 49.7 and 51.8 respectively. Neither number is very robust, but the global economy remains under pressure from tariffs and Brexit. U.S. PMIs were down materially in Q3 with Manufacturing falling to 47.8 and Services weakening to 52.6. While Prices showed strength, Employment and Inventories were weak. U.S. Services PMI bear close watching as any indication that U.S. consumer spending is weakening will likely result in global equity markets selling off. Eurozone PMIs deteriorated in Q3 with Manufacturing down from 47.6 to 45.7 and Services down from 53.6 to 51.6. Chinese PMIs were flat in Q3 at 49.8 for Manufacturing and 53.7 for Services. We would expect the resolution of the trade war with the U.S. to be the final stimulus to drive Chinese PMIs, and subsequently global growth, higher.

The S&P 500 generated total returns of 2.9%[7] during Q3 with weakness in August surrounded by strength in July and September. Global equities similarly generated total returns of 1.8%[7] in Q3 with a similar return pattern. Global real estate equities delivered a 6.1%[7] in Q3 as most global geographies and sectors delivered positive returns.

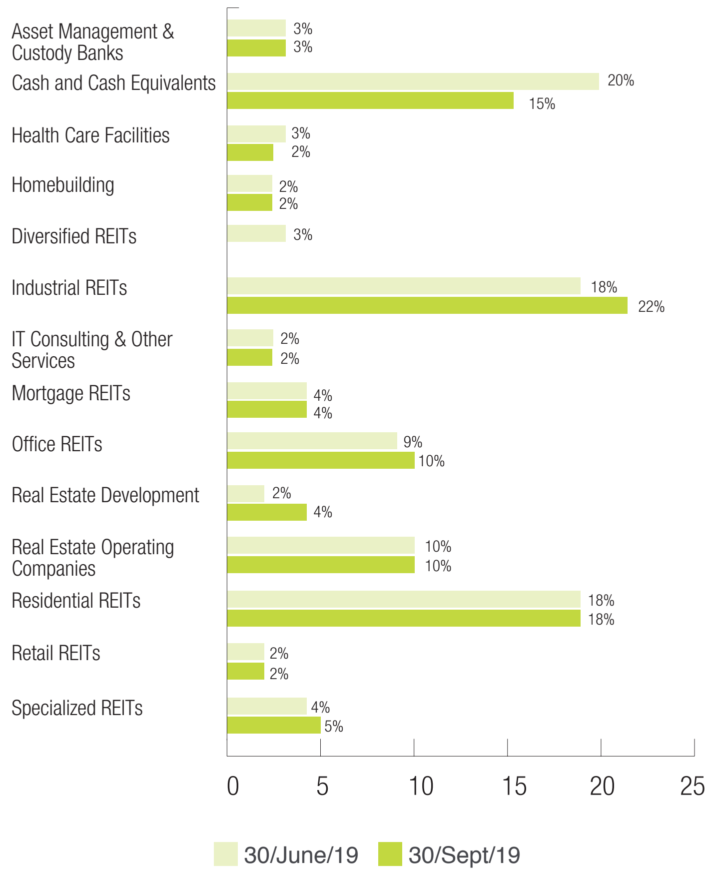
Starlight Global Real Estate Fund Portfolio Overview

The Fund's geographic and sector allocations are shown (adjacent) here. Assets Under Management (AUM) rose 32.6% in Q3. Incremental new capital was primarily allocated to existing positions in the Industrial REIT sectors for their higher growth trajectory. During Q3, two new Canadian positions were added to the portfolio –a multi-family position with European exposure and a real estate developer position. Against this, two were Canadian positions were eliminated, as both targets of M&A. From a geographic standpoint, capital was primarily allocated to U.S. positions as cash was deployed.

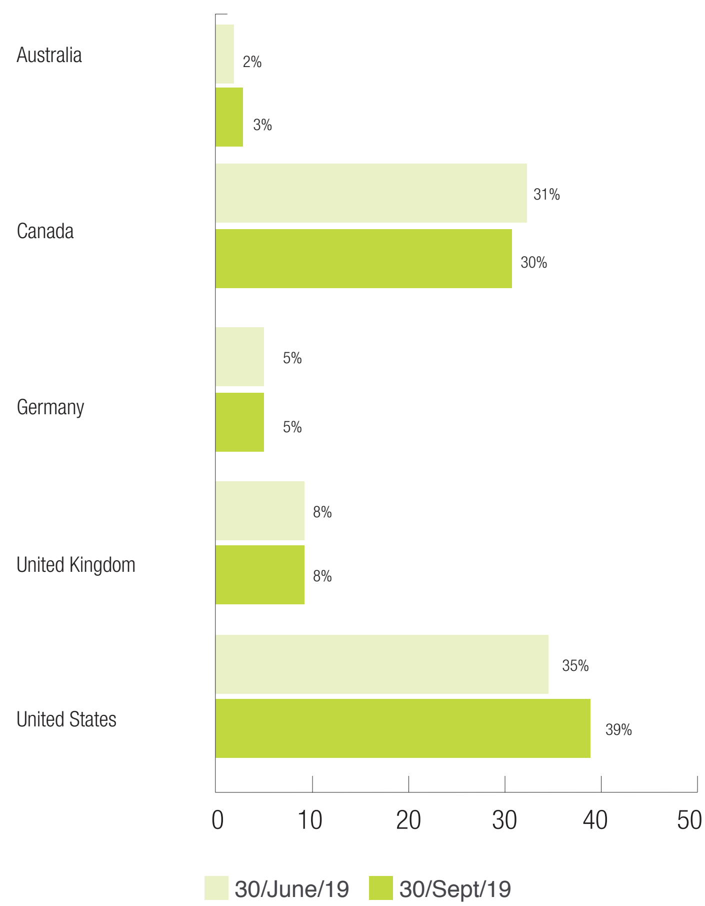
[4] U.S. Equity Strategy, Investors to Ignore Optimistic 2020 Estimates, Credit Suisse, 25 September 2019. [5] Source: The PULSE Monitor, Citi Research, 27 September 2019. [6] Source: IHS Markit.

[7] From June 28, 2019 to September 30, 2019. Source: Bloomberg LP. Global equities represented by MSCI World Index. Global real estate is represented by FTSE EPRA NAREIT DEVELOPED Total Return Index (CAD).

Starlight Global Real Estate Fund – Sector Allocation (%)



Starlight Global Real Estate Fund – Geographic Allocation (%)*



*excludes cash & cash equivalents

Portfolio Review

Two of the top contributors to Fund performance for the three months end September 30, 2019 were Dream Global REIT ("Dream Global"), with a total return of 22.8%[8] and, Minto Apartment REIT ("Minto"), with a total return of 20.8%[8].

Dream Global owns and operates a diversified portfolio of office and industrial properties located in key markets in Western Europe with a focus on Germany and the Netherlands. On September 15, 2019 Dream Global announced an agreement to be acquired by Blackstone Group for cash consideration of $16.79/unit. The offer price represented an 18.5% premium to the previous closing price on the TSX and will represent a total return for 2019 of 47%. We have exited our position in the company and added to names with Western European exposure.

Minto owns and manages a portfolio of more than 5,500 rental apartment suites primarily located in highly urban areas within Ottawa and Toronto and, to a lesser extent Montreal, Calgary and Edmonton. Minto was spun out by the Minto Group of Companies (retained a 49% interest) in July 2018 and has significantly outperformed, generating a total return of 47% versus the S&P/TSX Capped REIT Index at 23%[9]. Minto reported strong Q2/19 results, with FFO/unit growth that was 6% ahead of its IPO forecast and announced a 7.4% increase to its annual distribution. We continue to see upside to Minto's unit price, despite the strong performance during Q3/19, driven by a very favourable supply-demand imbalance for rental apartments in Canada and a positive macro backdrop.

Year-to-date, the **Starlight Global Real Estate Fund** experienced 23 dividends or distributions increases with an average of 6.7%, and two companies initiated dividends.

One of the top detractors from fund performance for the three months ended September 30, 2019 was Goodman Group ("Goodman"). Goodman is the largest industrial property group listed on the Australian Securities Exchange and one of the largest listed specialist investment managers of industrial property and business space globally. Goodman owns, develops, and manages industrial properties across 17 countries throughout Asia, Europe, North America and South America. The underperformance was largely attributable to three factors 1) on September 4, 2019 it was announced that Goodman would be excluded from the FTSE EPRA NAREIT index, 2) political uncertainty, and 3) investor rotation into value. We continue to hold our position in the company and have increased our position on the share price weakness.

Year-to-date, the Fund experienced 23 dividends or distributions increases with an average of 6.7%, and two companies initiated dividends.

[8] From June 28, 2019 to September 30, 2019. Source: Bloomberg LP.

[9] From July 3, 2018 to September 30, 2019. Source: Bloomberg LP.

Portfolio Outlook

The Starlight Global Real Estate Fund continues to hold 31 positions. Longer-term the portfolio should reach a targeted strategic allocation of 30% each to Europe, the U.S. and Canada supplemented by opportunistic investments in Asia and Australia. As Europe works through its legislative calendar, we expect to increase allocations to European real estate firms.

The industrial sector has generated double-digit total returns driven by the rise of e-commerce and the need for fulfillment centres, last-mile delivery and logistics facilities. We believe industrial businesses are still compelling on valuation while providing strong dividend growth.

We remain optimistic with respect to the multi-family sector and believe stock selection will be key to generating strong returns. We believe multi-family REITs offer an attractive risk/return profile driven by favourable supply-demand imbalances in many urban cities globally. We look for companies that generate strong cash flow, have a defensive balance sheet and provide exposure to markets with high barriers to entry.

Conversely, we remain cautious on the retail sector as we expect the negative sentiment from e-commerce to continue. Globally, we continue to see retailers reducing their square footage and retail rents declining. Appraisers are reducing retail valuations as the asset class remains out of favour with investors. We believe there continues to be too much supply, and the investment risk remains to the downside.

Overall, we believe the Fund is well positioned to participate in continued up-markets while providing downside protection. We will closely monitor the investment environment and actively manage the Fund's positioning by carefully selecting individual businesses in-line with Starlight Capital's proven investment philosophy.

Starlight Capital
1400–3280 Bloor Street West,
Toronto, Ontario, Canada M8X 2X3
info@starlightcapital.com
1-833-752-4683
starlightcapital.com

Starlight™ Capital