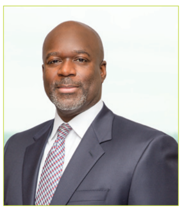
STARLIGHT GLOBAL REAL ESTATE FUND

Real estate total returns remain attractive



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Key takeaways

- Year-to-date, global real estate has generated a total return of 7.0%[1]
- Declining risk premiums have driven market multiples up while corporate earnings revisions have stabilized in positive territory for the year
- The extension of two key deadlines and the eventual positive resolution of these events should allow the market to avoid testing 2018 lows

Macroeconomic Update

On the back of declining risk premiums and rising market multiples, global equity markets have delivered strong total returns in 2019. Our expectation for 2019 is that it would be a battle between deteriorating economic output trends and positive economic fundamentals and so far, the latter is prevailing. Investors such as Ray Dalio have reduced their near term odds of a recession and corporate earnings forecasts have stabilized in positive territory for the year. With global central banks either stimulating (China, Japan) or pausing (U.S., Canada, European Central Bank (ECB), Bank of England (BoE)), financial conditions have ceased tightening and investor confidence has recovered.

As we move into March, two looming deadlines will likely be extended, giving markets some time to consolidate gains and position for possible outcomes. First, the March 1st deadline for a trade deal between the U.S. and China was extended and the proposed increase of existing tariffs on Chinese exports into the U.S. has been delayed. Trump wishes to host a second summit with Chinese President Xi at his Mar-A-Lago resort, where he will no doubt wish to unveil the largest/best trade deal in the world. We expect markets to take any deal and the elimination of tariffs as a positive, resulting in continued multiple expansion with the possibility of upwards earnings revisions to boost equity returns.

Second, the U.K. is poised to exit the EU on March 29th. Brexit negotiations continue and we expect the U.K. and the EU to agree to a short-term extension to finalize Prime Minister Theresa May's current proposal. While important issues remain unresolved, the inexorable march towards Brexit will serve to focus the U.K. parliament on formalizing May's deal as no viable alternative has been produced. Markets should respond positively to this outcome, particularly U.K. equities which still trade with a Brexit discount.

[1] Feb 28, 2019. Source: Bloomberg LP. Global real estate represented by FTSE EPRA NAREIT Developed Total Return Index (CAD)

Global Purchasing Managers' Indices (PMIs) rebounded in February with the composite at 52.6, up from 52.1. This is the first increase in global PMIs since Q2 of 2018 and was driven by services PMI growth which offset flat global manufacturing PMIs. Rising U.S. PMIs also offset declines in Europe and China. The end of the Federal Reserve Bank's tightening cycle combined with Chinese stimulus (now over 60 distinct easing measures since June 2018) should see global PMIs stabilize in the second half of 2019 or the first half of 2020. Barring the impeachment of the U.S. President or a central bank policy error, global equities should bridge the gap between current levels and 2018 market highs, without testing 2018 market lows.

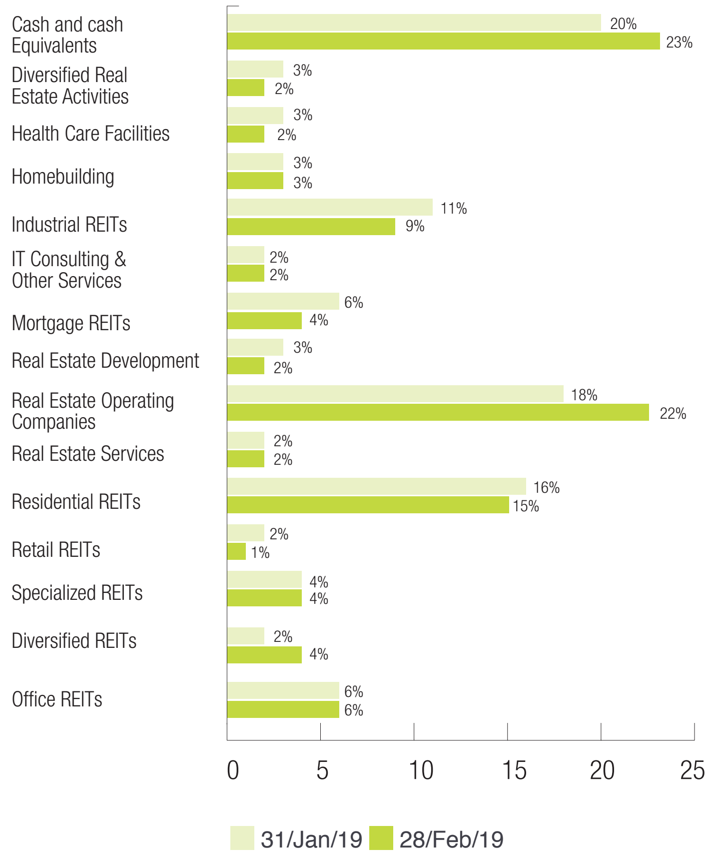
Global real estate has generated a total return of 7.0% year-to-date[2]. In February, global real estate underperformed global equities and U.S. equities (0.0%, 3.2% and 3.3% total returns[3], respectively). Despite the underperformance in February, over the long-term global real estate has outperformed global equities and U.S. equities (8.8%, 7.7% and 8.4% total returns[4], respectively) and this underscores the need for advisors to add a strategic allocation to their clients' portfolios.

Starlight Global Real Estate Fund

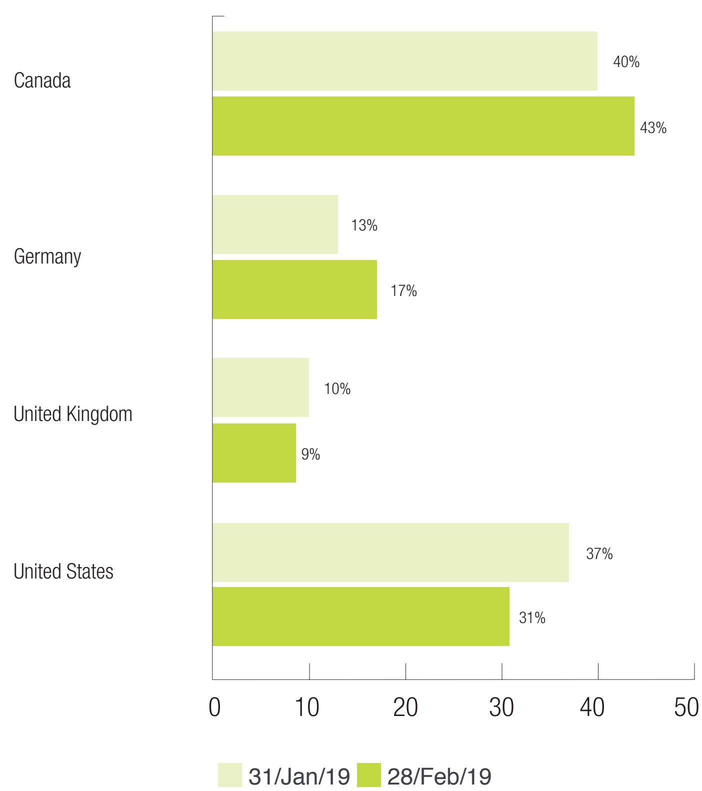
Overview

The Fund's geographic and sector allocations are shown (adjacent) here. Assets Under Management (AUM) rose 41% in February and this accounts for much of the increase in the Fund's Canadian holdings. Incremental new capital was largely allocated to our existing Canadian and German positions. We added one new position in February and no positions were eliminated. The Fund's cash weighting reflects our lag in deploying lumpy capital inflows as the market continued to rise.

Starlight Global Real Estate Fund – Sector Allocation (%)



Starlight Global Real Estate Fund – Geographic Allocation (%)



[2] As of February 28, 2019. Source: Bloomberg LP. Global real estate represented by the FTSE EPRA/NAREIT Developed Total Return Index (CAD). [3] As of February 28, 2019. Source: Bloomberg LP. Global real estate, global equities, and U.S. equities represented by the FTSE EPRA/NAREIT Developed Total Return Index (CAD), MSCI World Index (CAD) and S&P 500 Index (CAD), respectively. [4] Source: Bloomberg LP from Dec 31, 2002 – Feb 28, 2019. Global real estate, global equities, and U.S. equities represented by the FTSE EPRA/NAREIT Developed Total Return Index (CAD), MSCI World Index (CAD) and S&P 500 Index (CAD), respectively.

Portfolio Review

The top two contributors to fund performance in February were Dream Unlimited, with a total return of 12.7% and Brookfield Property Partners, with a total return of 9.7%.

Dream Unlimited is one of Canada's leading real estate companies with approximately $15 billion of AUM in North America and Europe. Dream's businesses include asset management and management services for funds, development, investments in and management of renewable energy infrastructure and the ownership of commercial property.

The firm's positive performance was driven by strong Q4/18 results, where EPS came in slightly ahead of consensus, and the announcement of an inaugural dividend of $0.10/share. The dividend announcement was a positive surprise and demonstrates the company's shift to more recurring income from asset management fees, distributions from public trusts, and property operating income versus Western Canada development when the firm went public in 2014. We continue to see upside to Dream Unlimited's shares with the stock still trading at only 52% of consensus net asset value, despite the strong outperformance year-to-date.

Brookfield Property Partners is one of the world's premier commercial real estate companies, with approximately USD $87 billion in total assets. The firm manages a diversified portfolio of premier office and retail assets, as well as opportunistic global investments in other asset classes. Brookfield Property Partners' investment objective is to generate attractive long-term returns on equity of 12%–15% based on stable cash flows and asset appreciation supported by annual distribution growth of 5%–8%.

The company's strong performance was driven by solid Q4/18 results, a 5% distribution increase, and the announcement of a USD$500 million Substantial Issuer Bid (5% of float) at a price of at least USD$19.00 per unit but not more than USD$21.00 per unit. We continue to see upside to Brookfield Property Partners with the units still trading at only 70% of consensus net asset value and almost a 7% yield, despite the strong outperformance year-to-date.

Year-to-date, six companies in the **Starlight Global Real Estate Fund** increased their dividends or distributions by an average 8.2%, and one company initiated a dividend.

The top detractor from fund performance in February was Grand City Properties S.A. ("Grand City"). Grand City owns more than 80,000 residential apartments in densely populated areas primarily in Germany. The company acquires value-add properties and focuses on modernization and intensive tenant management to drive occupancy and rent growth. In Q3/18 Grand City generated +10% y/y FFO1 growth and +9% NAV growth to €22/share. We see significant upside from current levels as 85% of the portfolio is rented at rents that are below market. We attribute the recent underperformance largely to concerns over the German economy and utilized the weakness to add to our position.

Year-to-date, five companies in the Starlight Global Real Estate Fund increased their dividends or distributions by an average 8.2%, and one company initiated a dividend.

Portfolio Outlook

The Starlight Global Real Estate Fund now holds 33 positions. We expect to continue deploying capital into these businesses on an opportunistic basis. 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 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.

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