Invesco Global Real Estate Fund

Quarterly review | As at March 31, 2023

Investment philosophy

Invesco Global Real Estate Fund seeks to generate a total return through capital growth and income by investing primarily in real estate securities from around the world. The Fund management team (the "team") uses a fundamentals-driven investment process, including market-cycle analysis and property evaluation, to identify companies with quality underlying properties, solid management and attractive valuations.

Performance summary

- Global-listed real estate reported positive absolute performance during the period, underperforming broader equities
- Invesco Global Real Estate Fund, Series I returned 1.54% over the quarter, outperforming its benchmark, the FTSE EPRA Nareit Developed Index, which returned 0.92% (C$) over the same period

Key contributors and detractors to performance

Global-listed real estate delivered positive absolute performance during the period. The Fund outperformed its benchmark primarily due to favourable stock selection in North America as well as stock selection and an underweight allocation to Europe, where many companies carried high leverage levels and were punished during the period.

The Fund's holdings in North America delivered positive absolute and relative performance. Relative outperformance was driven primarily by positive sector allocation and stock selection within the United States. Holdings in Canada delivered negative relative performance. Within the U.S., an underweight allocation to the office sector and stock selection within the self storage and multifamily sectors explained the majority of relative outperformance. An overweight allocation and stock selection within the industrials sector was also a key contributor.

The Fund also benefited from an underweight allocation to Europe. Within the region, REITs with higher investment leverage underperformed, while those with stronger balance sheets and resilient cashflows fared better. Positive performance was driven by holdings in defensively natured and secure, inflation-linked cashflow companies like European cell-tower operators. The Fund also benefited from being underweight Sweden, where companies are highly interest-rate sensitive. Additional gains were driven by exposure to the U.K., which has comparatively lower leveraged companies, and stock selection driven particularly by the recent consolidation between two deeply valued London retail landlords, which was well-received.

Detractors to relative performance included overweight exposure to Hong Kong and underweight exposure to Singapore. In Hong Kong, the Fund owned a retail landlord that announced a pre-emptive rights issuance[1], which was unexpected and caused the stock to trade lower. Additional losses were found in the healthcare sector, where a key holding detracted after management lowered its cashflow growth guidance.

[1] A pre-emptive rights issuances refers to a company offering existing shareholders the ability, but no obligation to buy additional shares in any future issue of a company's common stock, before they are made available to the general public. Pre-emptive rights indicate that a company is likely to issue additional shares of stock in the near future.

Fund activity

The Fund shows overweight exposure to real estate in the U.S. and Hong Kong. The Fund has underweight exposure to Europe, Canada and Japan. Overweight property type exposures are cell towers, residential and health care. Underweight property exposures include office and retail.

In North America, the Fund ended the period with overweight exposure to the U.S. and an underweight exposure to Canada, leading to neutral exposure in the North America region. Within the region, positioning favoured companies with more defensive growth characteristics and companies trading at attractive relative valuations. The Fund holds overweight positioning to the residential, industrial and healthcare sectors. The Fund holds underweight exposure to mall REITs, which face structural headwinds related to ecommerce and retail footprints that may need to be downsized. The Fund also has underweight exposure to self-storage REITs, which are experiencing growth deceleration as the temporary COVID-19 demand surplus is normalizing.

The Fund ended the period with an underweight weight to the Asia-Pacific region with key underweights located in Australia, Japan and Singapore. In Austaila, underweight exposure is notable within both retail and office landlords. The Fund is limiting exposure to Singapore, as REITs in the country exhibit above-average levels of financial leverage amid the rising cost of debt. In Europe, key active positioning reflects overweight exposure to Spanish diversified and Italian cell-tower properties. Large underweight exposures are to investments that either have high leverage or low-yield characteristics.

Market commentary

The global economy is now slowing as tighter financial conditions are gradually impacting aggregate demand. Potential inflections in the macro-economic environment are leading to volatile capital markets. Persistent demand, combined with supply chain challenges, has sustained inflationary pressures well-above tolerable levels, which has driven key central banks to significantly tighten financial conditions. Gaining inflation control without causing excessive economic growth destruction is proving a difficult task for central banks, with the tightening actions of the U.S. Federal Reserve proving most impactful on worldwide capital market sentiment. The recent banking sector stress that required government interventions in the U.S. and Switzerland have further complicated the policymakers' calculus. Additionally, heightened geopolitical instability is likely to negatively impact growth and increase economically problematic inflation. Further, capital market volatility generated by war, COVID-related news, uncertainty over inflation prospects and speculation over central bank policy should be anticipated in 2023.

In a slowing growth and higher inflation environment, maintenance of pricing power and ability to pass on inflationary cost increases is becoming increasingly important. Externally driven growth opportunities for REITs are expected to slow in an environment of tighter financial conditions. Listed real estate companies are generally maintaining financial discipline and absolute levels of debt remain in check; however, there will be examples of forced selling of assets where leverage levels are uncomfortably high. Overall earnings from real estate are expected to rise in 2023, albeit companies may choose to be more cautious in maintaining current dividend levels. Where reported, we expect to see net asset value declines throughout the first half of 2023 for property types in most geographies.

There is an overall desire to maintain a Fund with a bias toward companies with more favourable long term growth prospects, generally supported by higher-quality assets, attractive fundamental prospects, lower leveraged balance sheets and better environmental, social and governance characteristics. We remain vigilant for REITs that retain pricing power at attractive valuations. In addition, relative valuation analysis will also introduce exposure where a sharp decline in share prices offers asymmetric future upside opportunities. The unpredictable macro and geopolitical environments require constant monitoring of active factor, country and currency exposures in Funds. Within the broader investment market context, cashflow security, growth opportunity, inflation hedge characteristics, discounted valuations and the tangible asset nature of real estate appear to offer relative attraction to a diversified investor.

Performance of Invesco Global Real Estate Fund, Series I as at March 31, 2023: 1-year, -12.44%; 3-year, 5.23%; 5-year, 1.92%; and 10-year, 5.69%.

Performance of the FTSE EPRA Nareit Developed Index (Net) as at March 31, 2023: 1-year, -14.84%; 3-year, 4.83%; 5-year, 1.84%; and 10-year, 5.44%.

Important information

Source: Invesco. Data as at March 31, 2023, in Canadian dollars

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