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INVESTMENT MANAGEMENT

# Market Volatility and Its Impact on the REIT market

The volatility to global stocks over the past few days has been sharp and quick. The market had been very complacent regarding volatility as stocks had been seemingly only rising over the past 18 months or so. We believe this is a technical, liquidity event exacerbated by programmatic, algorithmic trading. All of the passive money flows over the past few years may be contributing to the volatility. Sudden market declines can snowball given the rise of computer trading and passive index investing.

It should be noted that there has been no change in the fundamental outlook for the economy, real estate markets, or technology markets. In fact, quite the opposite is true. The economy appears stronger today than it did a few months ago and cash earnings growth across the various sectors of the stock market appear stronger today than a few months ago. The wage growth data reported late last week of 2.9% should be a positive sign that economic growth is finally starting to benefit the working class to a small degree after almost a decade of near stagnation. The wage number may be cause for slightly elevated near-term inflation expectations, but this too should be a welcome sign that the coordinated monetary policy sought to trigger may finally be here. At the very least it demonstrates that the global economy is taking a step back from deflation and stagflation

There is no capital crisis. There is no liquidity squeeze occurring in the debt markets. While the 10-year U.S. Treasury has moved up in a short period of time over the past 8 weeks or so, there have been far worse periods for the 10-year yield just in this current cycle. Interest rates are up because economic growth is up. This is a good thing. There is no stress in the credit markets. Liquidity in the credit markets is good.

Investors may be nervous that the new head of the Federal Reserve, Jerome Powell, may not be as accommodative to the stock market as his predecessors Yellen and Bernanke had been. This is pure speculation and is not yet founded in fact. Mr. Powell is an unknown and markets fear the unknown. However, we take comfort in knowing that Fed Chairmen are notoriously cautious individuals.

As the pullback has affected the U.S. REIT market, understand that while REITs have underperformed year-to-date on higher rates and faster growth in more economically sensitive sectors, recently the REIT market has OUTPERFORMED the broader stock markets. Recent declines in the S&P 500, Dow Jones Industrial and other major global stock market indexes effectively retraced the year-to-date gains of these indexes. The US REIT market is down roughly 10% year-to-date. By contrast to the broad stock market, the U.S. REIT market represents good value being in "correction" territory. In the broad stock market, prices are merely back to late December after today's move. REITs are good values today.

Given how sudden and sharp the decline has been, there is likely to be a small period of dislocation in the markets (perhaps a few days or even a couple of weeks) as investors are reminded that investments involve risk and that volatility is alive and well, but generally speaking stock market crises--if that is even what we have here--are short-lived. The price movement in the late afternoon today felt very much like a technical, computer-driven panic not a real money crisis. The sharpest part of the day's decline happened very quickly but rebounded just as quickly. It was like a "mini flash crash." In our view that is a positive as it indicates it was not real money investors fleeing the market but algorithmic trading programs that broke down.



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