

Real Returns in Real Estate

Investing in international real estate is challenging for most individual investors due to a lack of accessibility to markets, the liquidity requirements of a large asset purchase, and recurrent risks posed by currency exposures. Brett Johnson, portfolio manager of Grubb & Ellis AGA International Realty Fund, describes his pursuit of real estate opportunities around the world.

Would you tell us about the fund's recent history?

The Grubb & Ellis AGA International Realty Fund, managed by Grubb & Ellis AGA Mutual Funds, was launched on December 31, 2008. The fund invests in the stocks of publicly-listed real estate companies that are located outside of the United States of America, with primary emphasis on Hong Kong, Japan, the U.K., Continental Europe, Singapore, Canada, and Australia.

What is your investment philosophy?

The fund invests in a diversified portfolio of equity securities of international realty companies. Our overall philosophy is, through extensive research, to identify and invest in attractively valued real estate stocks. The stock may be attractive because of healthy local economic growth, a supply-demand imbalance in a particular market or our expectations for the value of its development pipeline. Or we may just believe the company's assets are undervalued. We try to create a portfolio that offers both attractive growth potential and attractive value opportunities. The fund routinely invests in at least ten countries outside of the US and also can invest in emerging markets.

What does total return investment strategy involve?

We seek total return through the capital appreciation of international real estate securities over the long term, with a secondary objective of current income.

The fund invests in a diversified portfolio of equity securities of international realty companies, offering investors the potential to participate in local economies through real estate across the globe with the benefit of a professional management team. It may invest, directly or indirectly, in at least ten different countries outside of the U.S. and also invest in securities in emerging markets.

We seek total return over the long run through both the capital appreciation and dividend income of international real estate securities. Capital appreciation can be driven by improving underlying real estate fundamentals in a market or improved pricing for certain kinds of assets. Over the long run, the price of a real estate company's stock has a high correlation to the value of its real estate portfolio. For real estate companies that focus on owning and leasing their assets (like REITs), dividend income is often an



BRETT JOHNSON is the chief investment officer and portfolio manager for the Grubb & Ellis AGA Mutual Funds. His prior experience includes four years as vice president in the real estate equity research group of RBC Capital Markets and as an associate at Robertson Stephens. Johnson also worked in real estate acquisitions and development, which included overseas duties.

Johnson holds a bachelor's degree from Stanford University, and an MBA from the Wharton School of Business.

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important component of total return. These companies, which generally rely on stable rental income as their main source of revenue, have historically paid a dividend yield that exceeds the average dividend yield of the broader equity market.

Can you explain how investors gain access to internationally listed companies by investing in your fund?

One good example is in early-2009, when we initiated a position in a number of Hong Kong listed companies that have notable access to developments in China. The reason why we did this was the fiscal stimulus program in China was very supportive of residential development. There are a number of large Hong Kong based real estate companies that have deep development pipelines in China that we thought would benefit directly from this large fiscal stimulus program. And those companies have done very well since then as we've seen a significant amount of capital come from the Chinese government into the local real estate markets.

It would be extremely difficult for individual investors in the U.S. to otherwise access and participate in local fundamentals in the residential real estate market in Shanghai or Beijing without investing the way that we have in Hong Kong listed companies. So again it's providing investors access to markets that are difficult to have exposure.

What analytical steps do you take to conduct your research process?

We are very value driven in our research process. We look at the intrinsic value of a real estate company and compare that to the implied value that the shares are trading at in the stock market and focus on large discrepancies between the two. We focus on areas where our views differ notably from the market or the

consensus view and look for catalysts that will unlock the value discrepancies.

We maintain a large database organized by region which encompasses as much of the global, publicly-listed real estate sector as possible. We currently track over 400 international real estate companies.

The process of selecting stocks is a multi-faceted process. We look at a number of macro-economic factors by region, geopolitical factors, election cycles, and most importantly in the current market environment, we evaluate the fiscal stimulus programs of many governments internationally and their impact on the real estate market. Our experienced team travels to local markets regularly and understands how economies and real estate cycles operate throughout the world.

Then, from a bottom-up standpoint, we look at local markets supply and demand fundamentals and focus on where we believe the demand will be in excess of market expectations. Also, within individual companies, we look at which companies are best positioned to capitalize on the current environment.

As part of Grubb & Ellis, we have access through our affiliates to a large international network of real estate professionals. We believe this gives us a distinctive advantage in tracking emerging real estate trends, understanding local supply and demand characteristics, and selecting individual stocks.

We run various screens which help us sift through this massive universe. When we find a company is looking potentially attractive due to these metrics we go back and do additional research like listening to past conference calls, looking at investor presentations, building financial models, and holding a conference

call with company management. We look at the management track record, the style of the management team, and balance sheet strength. If we find the investment idea to be compelling after this initial round of research, we generally travel to their local office to meet with management in person and visit their most important real estate assets.

We have been following the universe of international real estate stocks very closely for many years so we are familiar with most of the companies. However, we are always looking for new ideas to add to the portfolio. Idea generation is a combination of keeping a database just to track everything that is going on, hearing about interesting trends or other companies during conversations with management teams, getting ideas from conferences, visiting a local market and seeing some thing that looks interesting, talking to the consultants or brokers of investment companies that are based in those markets and hearing what they are thinking.

For example, we purchased the stock of China Resources Land Ltd. in March of 2009. This is the real estate flagship of China Resources Group. The reason for buying this stock is because at the time global real estate values and the stocks were very depressed and China had come out with a very large fiscal stimulus targeting stimulus in the local real estate markets. And this company has a huge development pipeline in those markets. The stock was very inexpensive on a price-to-net asset value and a price-to-earnings multiple ratio relative to its historical averages.

Also, this particular company had a notable cash position, huge land bank, capacity to deliver a number of projects quickly, and was trading at a discount on a multiple basis to its largest peers. We liked this particular name because

it was in our view too inexpensive given its growth outlook. So kind of a combination of being positioned correctly at the right time for this part of the cycle and being attractively valued.

Another example is Corio NV, the second largest listed property investment company with a focus on retail in Europe. Most of their investments are in The Netherlands, France and Italy. We invested in this company in June of 2009 shortly after they raised a significant amount of new equity capital which dramatically improved the company's balance sheet.

Post-issuance we thought that the dilution was out there and it was going to be their last major equity issuance for some time. The company's balance sheet was quite strong and they were in a position where they could opportunistically acquire distressed properties in some of their markets and that the dividend yield had exceeded 8% at that point. So, with a very high-dividend yield and a low multiple base we thought it was a great time to enter the stock.

How do you construct your portfolio?

We invest internationally across regions, currencies and property types. Our benchmark is the S&P Developed ex-U.S. Property Index. There are 290 stocks in our index that are all non-U.S. real estate stocks. There are over 100 stocks outside of the benchmark that we track as well. So it's probably about 400 different companies that we track. Our portfolio generally has 40 to 45 positions, or about 10% of what we would consider the investable universe although the vast majority of our portfolio is targeted at the markets within our benchmark.

We rely on our macroeconomic analysis to identify key themes that we believe will impact demand for real estate within each major region. We

proactively tilt the exposure within our portfolio towards the regions that we think have the best prospects. So, but overweighting the regions and property types that we believe have the best prospects and the most attractive valuation.

Given our target regional allocations, we conduct a detailed, fundamental research process to identify individual companies to create our global portfolio. We generally always have 90% to 100% of our capital invested in the stocks of real estate companies. We are value-based investors and look for companies that we think have the best relative value as well as absolute value. We also maintain a strict sell discipline, so as stocks rise and valuations become full, multiples begin to look expensive on a relative basis we'll start selling positions and look for other more attractively valued opportunities.

What role do currencies play in your investment process?

One benefit of this fund for U.S. investors is that they gain exposure to the underlying currencies of the markets in which we invest. When we buy a stock in another country, we own that stock in the local currency. If the value of that local currency rises against the US dollar, the investor would benefit from that rise in currency value. So the currency exposure in this fund is unhedged. Over time, if you believe that the dollar will fall against the basket of other currencies in our portfolio, that would be a benefit of owning this fund. But the flip side is, if over time, you believe that dollar would strengthen against a basket of foreign currencies then that would be a negative to owning this fund.

We have very limited exposure to emerging market currencies. The vast majority of our currency exposure is to the large international developed

currencies like the Euro, Yen, Hong Kong Dollar and Australian Dollar.

The reason for investing in developed markets is that currently when we invest in real estate stocks, we are in part limited by the number of publicly listed stocks that trade on a given market. Generally, the real estate assets in most emerging markets are owned by wealthy families or institutional investors. There are not very many real estate companies that have listed stock on the public market that trade. We certainly track emerging markets very closely. But we do not currently invest aggressively in these markets. As more companies get listed in these markets, we would expect the portion of our portfolio that invest in these markets to increase.

What valuation metrics do you use to identify different segments in your investment universe?

Real estate is definitely a cyclical industry and the cycles within each of the property types and between regions are also very different. We track a variety of valuation metrics like price to earnings and price to NAV, which is the net asset value of the underlying real estate. We also evaluate growth prospects by studying supply and demand fundamentals for each property type within each region. We evaluate when owners or developers within that property type will gain pricing power, capture larger margins and deliver properties with premium pricing. We target owning stocks that have appealing growth prospects yet trade at attractive valuations.

What are your views on risk and how do you control?

We have many ways for managing risk. We closely follow all of the companies that we invest in by tracking daily news flow. We manage company-specific risk by staying abreast of what's happening.

Also, we have limitations in our position sizes that are not mandated but that we generally target internally. We have a benchmark and generally keep our position sizes within a reasonable range of what that position represents within the benchmark.

Generally, we seek to maintain a diversified portfolio by region. Therefore, by owning a diversified portfolio across a region, the portfolio as a whole has the potential to be less volatile than the average volatility within an individual region because of the interaction in owning a portfolio of all of them. We diversify across region and currency and having 40 to 45 names in the portfolio, which should be an average position size of 2% to 2.5% per name. This helps us manage currency risk, region risk and company risk.

We have detailed valuations and price targets for each of our investments. We have a sell discipline as names are reaching price targets. We have internal controls to track if stocks are moving notably above or below our expectation.

What is the advantage of investing in real estate through stock market?

Advantages of investing in real estate stocks include access to different markets, the benefits of diversification, professional management and access to daily liquidity.


Many foreign countries have restrictions that make it extremely difficult for an individual U.S. investor to own property in that country. In the example I mentioned before, a U.S. investor that wants to participate in local real estate fundamentals in the residential real estate market in Shanghai or Beijing really needs to invest in Hong Kong listed companies.

There are many other examples like this. So being able to invest in real estate via the stock market is a huge benefit.

The real estate has generally been grouped into an alternative asset class category that has gained significant acceptance in the last decade as an important component for individual and institutional investors in a diversified portfolio. The reason being that on several metrics like the overall return, the volatility of returns and the correlation of those returns to other returns in a diversified portfolio, it's been shown that real estate makes a nice addition to a portfolio.

Over the long run, the returns of underlying real estate properties and the returns of the stocks of the companies that invest in these properties are highly correlated. Said another way, the returns of these companies are driven by the returns of what they own, which is the real estate property. So investing in real estate stocks gives investors access to the underlying returns of the hard assets of the real estate asset class.

Another factor to consider is that an investor buying a property would have to manage that property. But when they invest in real estate securities, they're investing in companies that take care of the property management for the investor.

Owning stocks also gives an investor intraday liquidity, so they can sell at any time. However, if an investor owns a real estate asset and decides to sell, it can take weeks, months, or even years to sell at the price that the investor is looking to obtain. Certainly, an investor in real estate assets do not have daily liquidity like an investor in real estate securities. 

Grubb & Ellis AGA International Realty Fund

Symbol	GBEWX
Website	www.gbemutualfunds.com
Address	Grubb & Ellis Alesco Global Advisors 400 S. El Camino Real Suite 1250 San Mateo, CA 94402
Telephone	877-404-7822
Inception	12/31/2008

PORTFOLIO	
Total Net Assets *	N/A
Avg Mkt Cap (\$ Weighted) *	\$11,600
Average Price/Earnings Ratio	23.85x
Average Price/Book Ratio	1.5x
Turnover Ratio	N/A

INVESTMENT INFORMATION	
New Investment	Open
Min Initial Investment	\$2,000
Min Subsequent Investment	\$100
Min Initial IRA Investment	N/A

RETURNS VS. S&P DEVELOPED EX-US PROPERTY INDEX		
	GBEWX	Index
Quarter	17.18%	21.18%
YTD	82.80%	40.78%
Since Inception	82.80%	40.78%

FEES AND EXPENSES	
Max Sales Charge - Front**	5.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee***	1.00%
Total Expense Ratio	N/A

PORTFOLIO MANAGER	
Brett Johnson	2008

*millions **for amount invested less than \$100,000

***3 months after purchase

09/30/2009; Source: Company Documents; Lipper

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