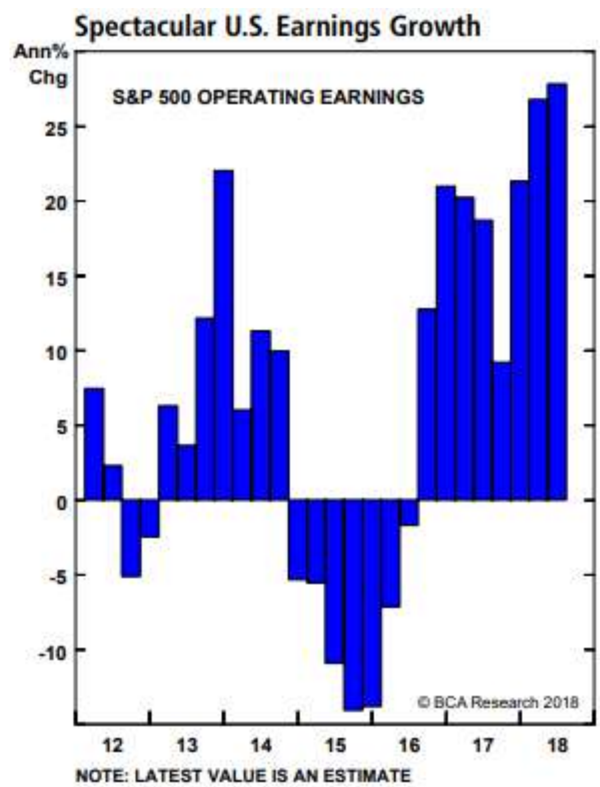
July 2018

By the end of the month the S&P 500, which has been in an uptrend since April 2nd, was within striking distance of ending the current correction, while 2Q GDP was estimated to have grown 4.1%, the fastest since 3Q14. By the end of last week the unemployment rate was back down to 3.9%, and Apple became the first company to reach a trillion dollars in market cap. On August 3rd BCA Research's Chief Economist Martin Barnes published a Special Report titled **Personal Observations On The Current Environment**, in which he detailed his "concerns about a number of issues" including:

- The consensus may be too complacent about the timing of the next U.S. recession. The dark side of current strong growth is growing capacity pressures that warn of upside surprises for inflation and thus interest rates. (We share this portion of his analysis below.)
- Uncertainty about trade wars represents a risk to the global economic outlook beyond the direct impact of tariffs because it also gives companies a good reason to hold back on investment spending. (We are more sanguine here, as Trump is far more concerned about optics than substance. He creates chaos, than takes credit for solving it. The renegotiation of the South Korean trade agreement changed nothing of substance, he has already placed on hold further tariffs on the EU while negotiations are "progressing", and, if we are correct, will reach a deal on NAFTA before the midterm elections. China will be a harder nut to crack, but the impact on our economy will not be significant over the medium term. "While China has an economic incentive to make concessions," Barnes "cannot imagine that President Xi wants to be seen as giving ground in the face of U.S. bullying.")
- Profit growth in the U.S. has remained much stronger than I expected, but the forces driving this performance are temporary. Rising pressures on wages suggest that labor's share of income will rise, leading to lower margins.
- The geopolitical environment is ugly, ranging from a shambolic Brexit process to rising populist pressures in Europe (Having just returned from 3 weeks in Europe, it is clear that immigration remains the driving force behind the pressure.), a flaring in U.S./Iran tensions and possible (almost certain) disappointment with North Korea negotiations (although we consider this last point to be of relatively minor significance, with Trump having already declared our "biggest and most dangerous problem" all but resolved). ...



Timing The Next Recession

Sad to say, economists do a very poor job of forecasting recessions. ... the Fed has missed every recession in the past 60 years (Table 1). One could argue that the Fed could never publish a forecast of recession because it would be an admission of policy failure: they generally have to be seen aiming for soft landings. But private forecasters have not done any better. For example, the consensus of almost 50 private forecasters published in mid-November 2007 was that the U.S. economy would grow by 2.5% in the year to 2008 Q4. The reality was that the economy was then at the precipice of its worst downturn since the 1930s.

TABLE 1

Fed Economic Forecasts Versus Outcome

FORECAST MADE	FORECAST CHANGE IN REAL GDP OVER NEXT 4 QUARTERS	ACTUAL CHANGE IN REAL GDP OVER NEXT 4 QUARTERS*	PEAK-TO-TROUGH % DROP IN GDP*
DECEMBER 1969	1.4%	-1.2%	-1.5%
NOVEMBER 1973	2.4%	-4.9%	-7.8%
JULY 1981	0.9%	-1.9%	-2.5%
JULY 1990	1.9%	-0.8%	-0.8%
MARCH 2001	2.6%	1.4%	-0.3%
DECEMBER 2007	1.3%	-0.5%	-4.2%

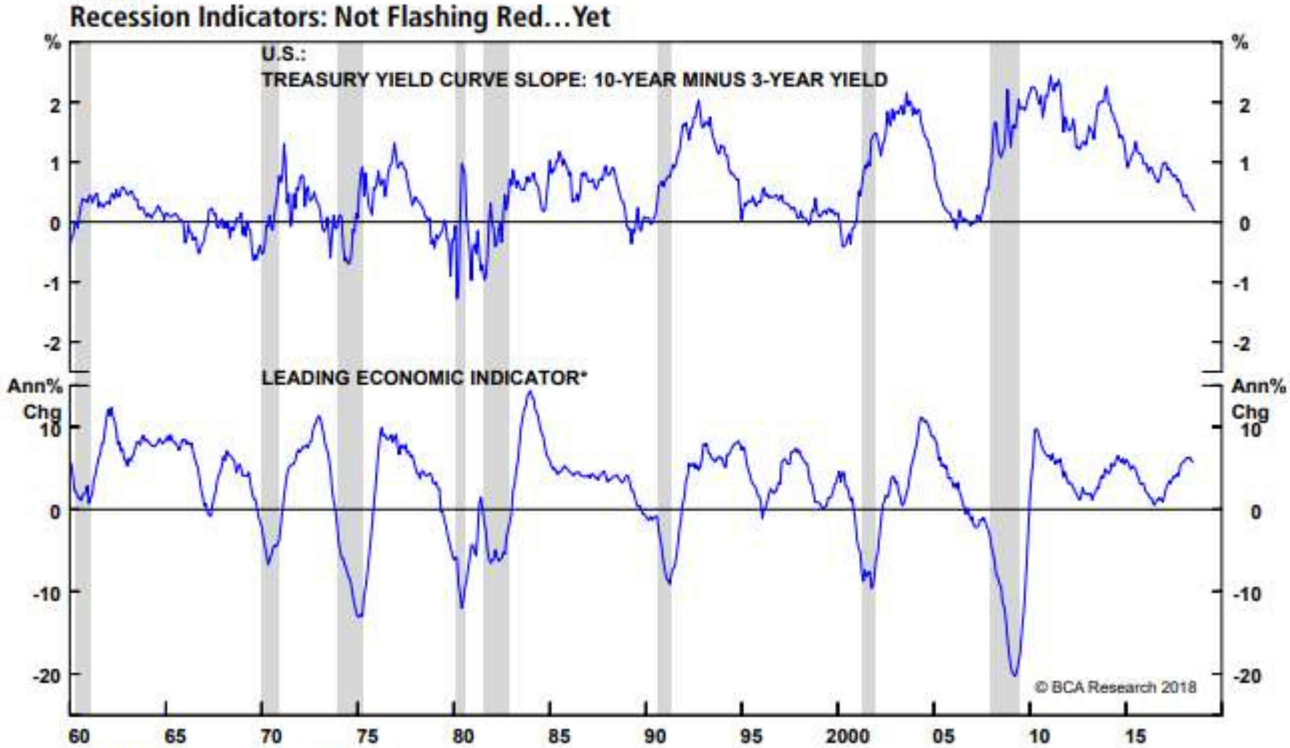
* THESE CALCULATIONS ARE BASED ON THE GDP DATA AVAILABLE AT THE TIME, NOT CURRENTLY PUBLISHED GDP DATA WITH REVISIONS AND CHANGES TO DEFINITIONS ETC.

The U.S. economy currently is very strong, but that often is the case just a few quarters before a recession starts. Strong growth today is not a predictor of future strong growth. As has been widely acknowledged, the yield curve has been one of the few indicators to give advance warning of economic trouble ahead. ...

However, the curve has flattened even as the Fed has pulled back from quantitative easing. As usual, the flattening reflects the tightening in monetary policy and, therefore, should not be discounted. To be fair, there is still a positive slope across the curve, so this indicator is not yet flashing red. But it is headed in that direction (Chart 1).

CHART 1

Recession Indicators: Not Flashing Red…Yet

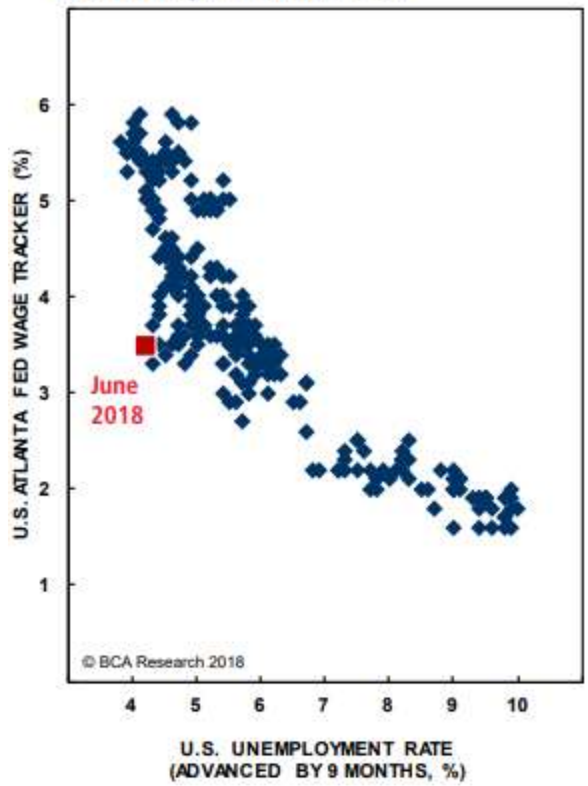


* SOURCE: THE CONFERENCE BOARD.
NOTE: SHADING DENOTES NBER-DESIGNATED RECESSIONS

The other series to watch closely is the Conference Board's Leading Economic Index. Typically, the annual rate of change in this index turns negative ahead of recessions, although once again, there is a history of forecasters ignoring or downplaying the message of this signal. Currently, the growth in the index is firmly in positive territory, so no alarm bells are ringing.

Overall, there are no indications that a U.S. recession is imminent. At the same time, late cycle pressures and thus risks are building. Anecdotal evidence abounds of labor shortages and supply bottlenecks in a number of industries. Wage growth has stayed relatively muted given the low unemployment rate, but that is starting to change. My colleague Peter Berezin has shown compelling evidence of a "kinked" relationship between wage growth and unemployment whereby the former accelerates noticeably after the latter drops below its full employment level (Chart 2). We are at the point where wage growth should accelerate and it is significant that the 2.8% rise in the employment cost index in the year to the second quarter was the largest rise in a decade.

CHART 2
Faster Wage Growth Ahead



It also should be noted that the Fed's preferred inflation measure (the core personal consumption deflator) has been running at around a 2% pace in the past three quarters, in line with its target. As capacity pressures build, an overshoot of 2% seems inevitable, forcing the Fed to react. Current market expectations that the funds rate will rise by only 25 basis points over the remainder of this year and by 100 basis points in 2019 are likely to prove too optimistic.

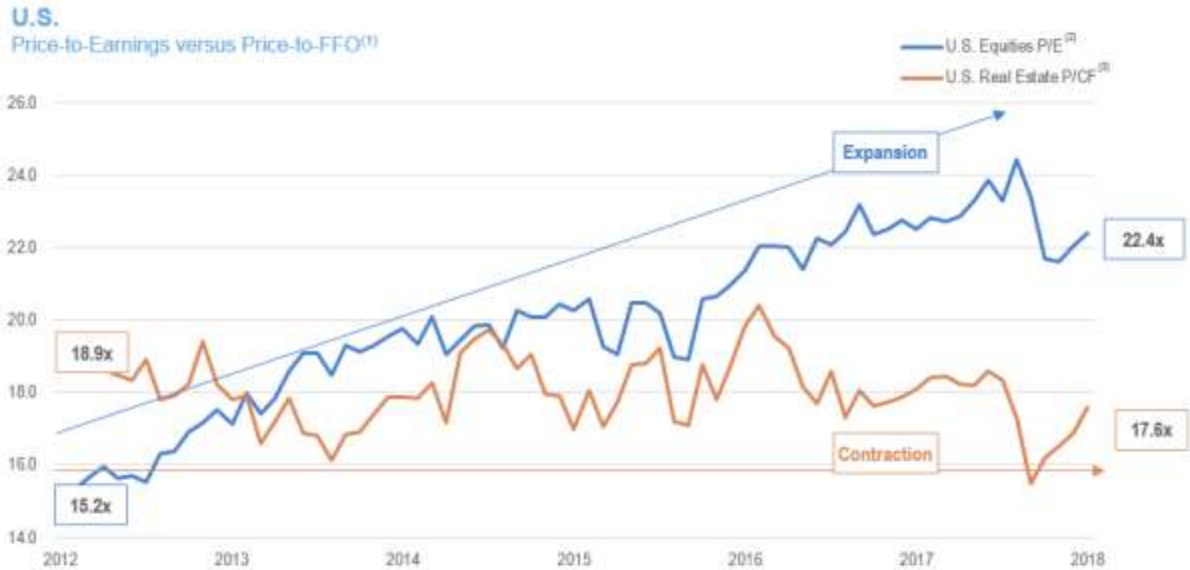
Admittedly, there is huge uncertainty about what interest rate level will be restrictive enough to damage growth. Historically, recessions did not occur until the fed funds rate reached at least the level of potential GDP growth. The Congressional Budget Office estimates that potential GDP growth will average around 4% over the coming year, and the funds rate probably will not reach that level in 2019. However, additional restraint is coming from the strong dollar, and lingering high debt burdens mean that rates are likely to bite at lower levels than past relationships would suggest.

We consider Real Estate a separate Asset Class, and continue to recommend at least a 10% allocation in most portfolios via publicly traded REITs. From Forbes Real Estate Investor's August 2018 issue:

Evan Serton is a portfolio manager with Cohen & Steers, which manages $60.1 billion of capital (as of June 30, 2018), specializing in liquid real assets, including REITs and infrastructure. Regarding the current REIT environment, Serton explained ... that at the beginning of 2018 REITs sold off around 9%-10% in direct response to the 10-year Treasury rate and conservative earnings guidance from most REITs. However, Serton explained, "REITs snapped back in the second quarter, delivering around 10% returns." He said REITs have enjoyed "renewed investor enthusiasm."

... according to Serton, "when REITs began to trade at a discount to NAV, the following 12 months have typically been very strong." ... He expects to continue to see strong earnings growth in the REIT sector and cites "97 consecutive quarters of positive job growth" ....

Overall, REITs remain one of the most attractive asset classes today. Serton pointed out, "we've been talking about the divergence of performance between the equity market and REITs and we believe this is one of the most favorable levels we've seen." REITs have historically traded at higher multiples, but there has been no expansion in REIT markets. Serton went on to say, "if equity markets are stretched, U.S. REITs are well-positioned to benefit from relative value. There is a substantial case to close the valuation gap."



At June 30, 2018.
Data quoted represents past performance, which is no guarantee of future results. The information presented above does not reflect the performance of any fund or account managed or serviced by Cohen & Steers, and there is no guarantee that investors will experience the type of performance reflected above. There is no guarantee that any historical trend illustrated above will be repeated in the future, and there is no way to predict precisely when such a trend might begin. An investor cannot invest directly in an index and index performance does not reflect the deduction of any fees, expenses or taxes.

Source: Cohen & Steers estimates based on proprietary qualitative and quantitative metrics.
(1) (FFO) Funds from operations is the REIT industry's key earnings metric. It is calculated as GAAP net income, plus real estate gains (minus real estate losses), plus GAAP real estate depreciation and amortization.
The price/earnings ratio (often shortened to the P/E ratio or the PER) is the ratio of a company's stock price to the company's earnings per share. Earnings multiples are the ratio of a company's share value to the amount of profit it makes in a particular period, whether paid out in dividends or not.
(2) U.S. Equities represented by the Russell 3000 Index which is a capitalization-weighted stock market index, maintained by FTSE Russell, that seeks to be a benchmark of the entire U.S stock market. It measures the performance of the 3,000 largest publicly held companies incorporated in America as measured by total market capitalization, and represents approximately 98% of the American public equity market.
(3) U.S. Real Estate represented by the FTSE NAREIT Equity REIT Index which contains all tax-qualified REITs except timber and infrastructure REITs with more than 50% of total assets in qualifying real estate assets other than mortgages secured by real property that also meet minimum size and liquidity criteria.
Earnings multiples are the ratio of a company's share value to the amount of profit it makes in a particular period, whether paid out in dividends or not.

REITs historically deliver the best returns during economic growth. Serton said Cohen & Steers' mantra is "rising rents are more important than rising rates."

From July 3rd's WSJ, as a follow-up to last month's newsletter:

Regulators Take Aim At Private Stake Sales

By Jean Eaglesham and Coulter Jones

Regulators are stepping up enforcement on the sale of private stakes in companies, following a Wall Street Journal investigation that found securities firms with unusually high numbers of troubled brokers selling tens of billions of dollars a year of these investments, often targeting seniors.

The Massachusetts chief financial regulator announced a probe on Monday into 10 brokerage firms in the state selling investments, known as private placements, as a result of the Journal's reporting.

"Private placements are risky investments that reward the salesperson handsomely with high commissions," said the Massachusetts regulator, William Galvin.

Brokers with a history of disciplinary actions "magnify the risk of unsuitable sales in connection with private placements," he added.

The North American Securities Administrators Association, which represents all state regulators, said it plans to work even closer with federal law enforcement to target bad actors following the Journal's reporting.

Sales of private placements, which can be stakes in anything from a real-estate development to an oil well, are booming: More than 1,200 brokerage firms sold around $710 billion of private placements last year, a nearly threefold rise from 2009.

The Journal found that firms selling private placements tend to have higher numbers of brokers with red flags such as investor complaints, regulatory actions or criminal charges and are more likely to be booted from the industry.

Around one in eight brokers marketing private placements carried three or more red flags on their records, compared with one in 50 in the broader industry, the Journal previously reported.

Private placements are generally subject to less policing and have fewer rules about what financial information to disclose to investors than the more transparent public markets, like stocks and bonds. ...

"We have heard the refrain after virtually every major investment scandal that regulators will work closer and coordinate," said Andrew Stoltmann, president of the Public Investors Arbitration Bar Association. "Unfortunately, it simply doesn't happen."

Private placements can offer better returns than publicly traded stocks and bonds, but are generally riskier and harder to trade. Sales are typically restricted to "accredited" individuals, meaning those with more than either a $200,000 net income or a net worth of $1 million, excluding homes.

Former regulators said private placements can attract bad actors because of the lax policing and high commissions.

"The Journal's findings further show the need for tough policing in this space," said Brad Bennett, a former chief of enforcement at Finra and now a partner at law firm Baker Botts LLP.

A spokeswoman at the Financial Industry Regulatory Authority said private placements have "long been an examination priority and continue to be an area of focus" in its oversight of the brokerage industry.

A Securities and Exchange Commission spokesman said that "cases involving private placements have long been and continue to be a core part of our enforcement program, particularly when retail investors are the victims."

The agency is trying to make it easier for investors to check the credentials of people selling investments, following the $1.2 billion blowup in December of a real-estate business that used private placements for fundraising. California-based Woodbridge Group of Companies LLC sold these private placement-related investments through a national network of unregistered sales agents, as well as some brokers and investment advisers, before filing for bankruptcy in December.

Woodbridge in April agreed to settle an SEC enforcement action, without admitting or denying the allegations. The company has said it is cooperating with regulators.

The SEC recently added more people to a database it launched this year, allowing investors to look up individuals it has sued in cases from October 2013 through March of this year. The database now covers more than 2,200 people, aged from 20 to 89, who have had SEC cases against them, according to data provided in response to a public-records request by the Journal. ...

Positions

BPY - On 7/3 established 2% positions for several clients:

Insider Buying:

Trade Date	No. Part	Participants	Net Sell (Shares)	Net Buy (Shares)
06/28/2018	1	DENARDO STEPHEN		700
06/22/2018	1	DAVIS BRYAN K		20,000
05/22/2018	1	KINGSTON BRIAN W		19,000
05/18/2018	1	KINGSTON BRIAN W		31,000
05/14/2018	1	MAROUN LOUIS JOSEPH		1,000
05/08/2018	1	DENARDO STEPHEN		1,050

A Global Real Estate L.P. That Yields 6.4%

Jul. 3, 2018

Brad Thomas

Summary

- BAM is the external manger to BPY that was spun out in 2013 as the “everything real estate” holding company.
- BPY is a Bermuda-based L.P. that generates K1’s as opposed to 1099’s, so certain investors are unable to own shares because the structure is not as tax friendly.

- L.P.'s (like BPY) cannot be listed in the RMZ or NAREIT Indexes, so it was necessary for BAM to structure the GGP deal specifically to fit into the REIT mold.
- I can foresee the potential for BPR to further consolidate BPY trophies, including the Rouse Mall portfolio.

Many readers have asked me to write an article on **Brookfield Property Partners, L.P.** (NYSE:BPY) and up until recently, I have not been able to find the time to do my necessary homework and provide a research report. However, a few things have changed so now I can finally deliver on my promise.

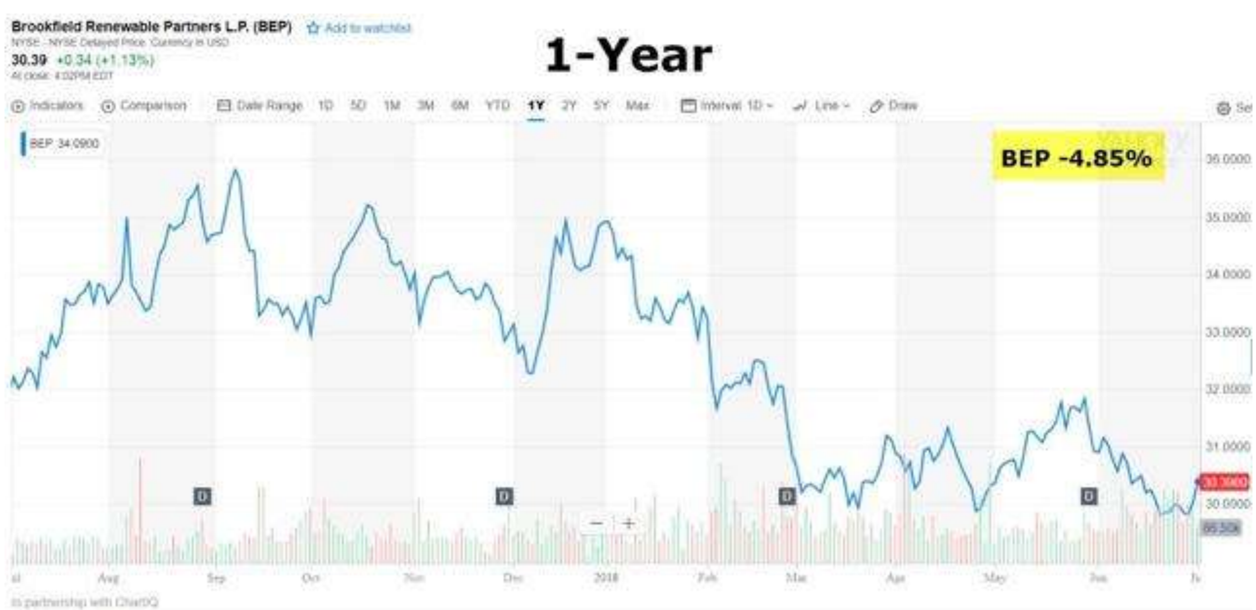
Hopefully, (in the next edition of my newsletter) I will be able to make contact with the management team at BPY. Although the company is structured as a Bermuda-based Limited Partnership (or L.P.), there will soon be a REIT underneath the entity referred to as Brookfield Property REIT (proposed: BPR).

This may seem complicated, so I will attempt to dummy this down…

Brookfield Asset Management (NYSE:BAM) is the external manger to BPY (... a Bermuda-based L.P.) that was spun out in 2013 as the "everything real estate" holding company for BAM. Essentially, BPY is the flagship holding company for BAM, and in addition to BPY, BAM is the asset manager for three other flagship vehicles (all are Bermuda-based L.P.'s): **Brookfield Infrastructure Partners** (BIP), **Brookfield Renewable Partners** (BEP) (which is held by a HCM client), and **Brookfield Business Partners** (BBU). ...

Brookfield Renewable Partners is one of the largest pure-play renewable power investors globally, with an extensive track record in hydroelectric power generation. BEP's assets, located in North and South America and Europe, leverage the company's expertise as owners and operators, as the focus is on generating attractive total returns over the long term.

BEP's business has a number of advantages supporting cash flow growth and capital appreciation, and benefits from technological and geographical diversification. In addition, BPY sells the majority of power under long-term, inflation-linked contracts that allow the company to capture increases in power prices over time. **BEP yields 6.52%.**



As noted, all four of the BAM-managed entities are Bermuda-based, and while I'm no tax attorney, I suspect that the company has elected to locate its operations in the most tax efficient country. Also, keep in mind that all four of the entities referenced are L.P.'s so they generate K1's instead of 1099's.

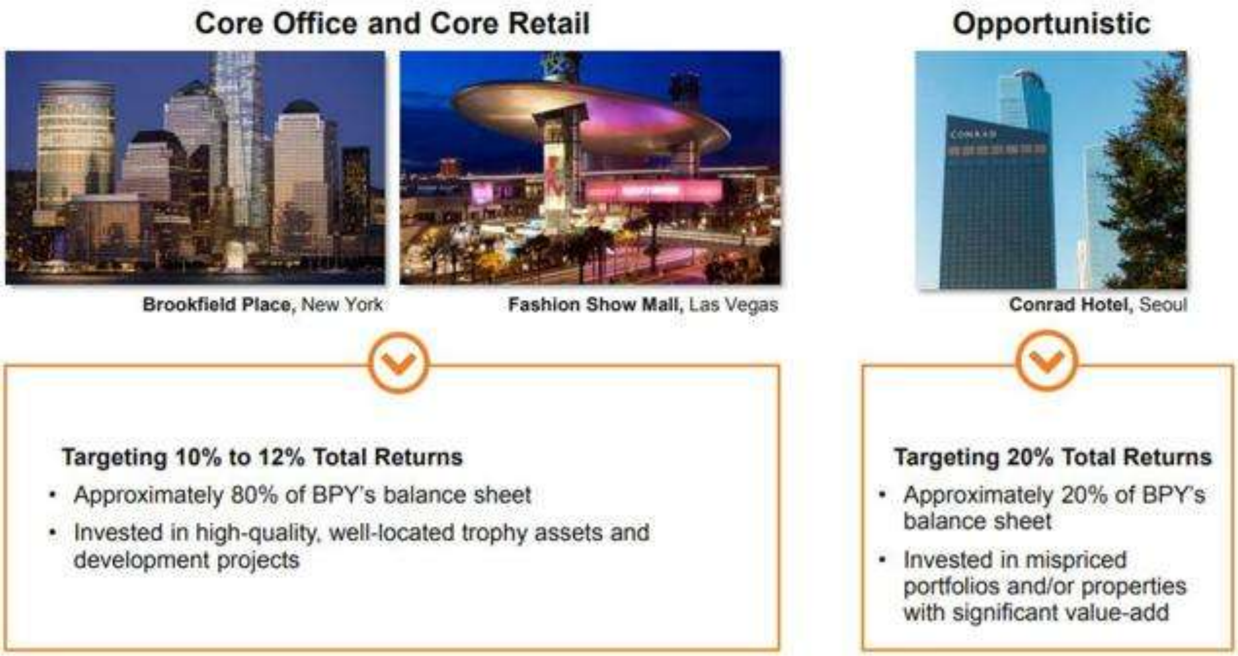
However, BAM is taxed as a C-Corp., and this leading alternative asset manager has a massive portfolio under management that spans over 30 countries globally. These businesses are each important components of the backbone of the global economy, supporting the endeavors of individuals, corporations and governments worldwide.

By sourcing capital from investors and shareholders – alongside its own capital – BAM is able to undertake transactions that few others can pursue. In addition, BAM's extensive operating expertise, development capabilities and effective financing experience enables the company to increase the cash flow of the assets within its operating businesses and create incremental value. ...

Brookfield Property Partners (BPY) is a diversified global real estate company that owns, operates and develops one of the largest portfolios of office, retail, multifamily, industrial, hospitality, triple net lease, self-storage, student housing and manufactured housing assets.

Its investment objective is to generate attractive long-term returns on equity of 12%−15% based on stable cash flows, asset appreciation and annual distribution growth of 5%−8%. The company seeks to accomplish this objective by acquiring high quality assets in resilient and dynamic markets and pursuing diversification across both geographic areas and real estate sectors, and continually recycling capital from stabilized assets at or near peak values into higher-yielding strategies.

Brookfield Property Partners' portfolio features some of the world's best-known commercial properties, primarily consisting of best-in-class office (147 premier properties -100 million square feet), retail properties in dynamic markets (125 best-in-class malls and urban retail properties -122 million square feet), and opportunistic investments (26,200 multifamily units, 20 hospitality properties, 326 triple-net-lease assets, and 206 self-storage properties).



You may recall that I have been covering **General Growth Properties** (GGP) for quite some time, and it was no surprise when I read that BPY was attempting to acquire the Chicago-based Mall REIT for $9.25 billion in cash. BPY already controlled a one-third stake in GGP, and to sweeten the pot, BPY offered the combination of cash, BPY units or a share of the new publicly-traded REIT, Brookfield Property Partners (proposed BPR).

The cash portion is fully funded with a committed acquisition facility and ~$4B of equity from strategic and noteworthy joint venture partners. The financing will be repaid through additional asset sales and asset-level financings over time. This will result in an aggregate cash/equity consideration ratio of approximately 60%/40%.

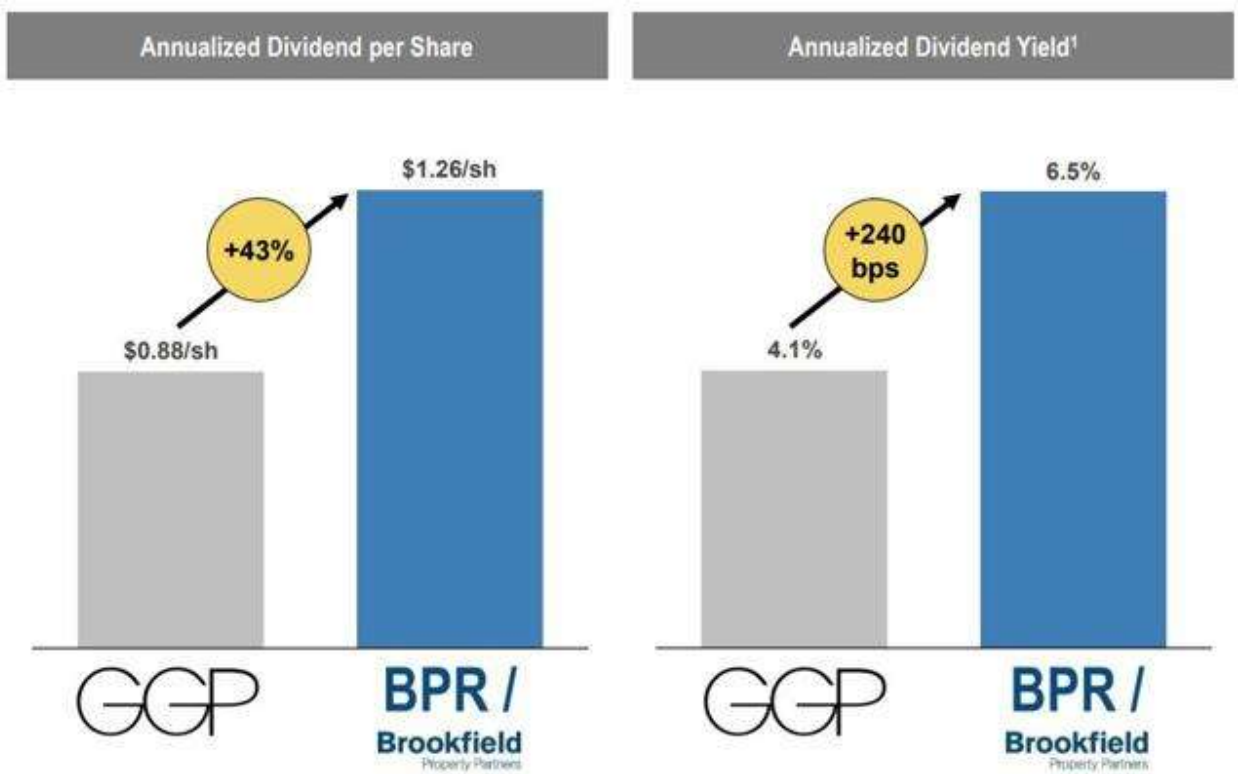
Why The REIT Structure?

As mentioned above, BPY is a Bermuda-based L.P. that generates K1's as opposed to 1099's, so certain investors are unable to own shares because the structure is not as tax-friendly. Secondly. L.P.'s (like BPY) cannot be listed in the RMZ or NAREIT Indexes, so it was necessary for BAM to structure the GGP deal specifically to fit into the REIT mold. BPR will be a publicly-traded REIT externally-managed by BAM. At time of the GGP acquisition, GGP shareholders can elect to receive cash, one BPY unit or one Class A share of BPR.

BPR Shares & BPY Units Share an Identical Economic Interest

	BPR	BPY	Details
Distributions	✓	✓	Distributions are identical in amount and timing
Exchangeable	✓	N/A	Class A BPR shares are exchangeable for a BPY unit or the equivalent value in cash
Liquidation Value	✓	✓	Liquidations values are equalized
Voting Rights	✓	N/A	Voting control for both BPR and BPY is aligned as BPR's majority shareholder is BPY
Majority Owner	BPY	BAM	BPY will own at least 60% of the outstanding shares of BPR and BAM will hold ~52% of BPY post transaction
Assets	GGP Only	Diversified	To comply with REIT rules, BPR's assets will be made up of a selection of the GGP assets while BPY will continue to hold a diversified asset base

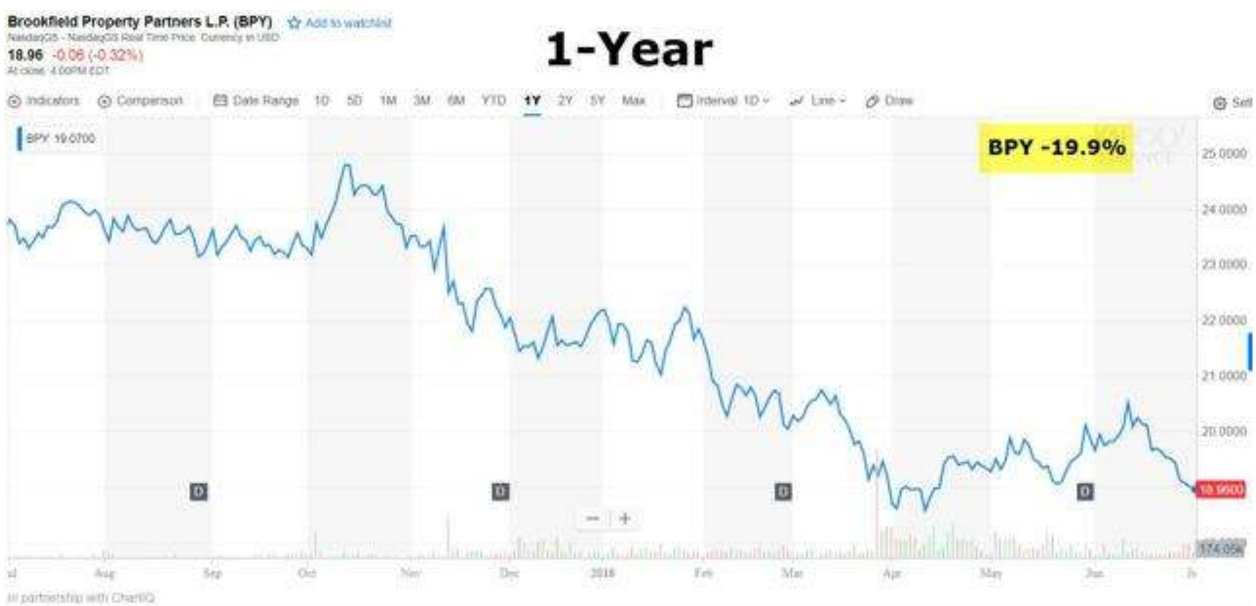
So BPY is essentially a tax flow entity with a new REIT underneath, and because BPY was an L.P., U.S. REIT investors were not able to gain access to shares in GGP. As illustrated below, that's no longer a problem and investors will soon be able to own shares, with a significantly higher yield than the current GGP yield.



It appears that the payout ratio has sufficient cushion to protect distribution levels and to fund growth (20% of CFFO will be retained). Also, although I am not a fan of external management, I'm happy to see the strong insider ownership by BAM, that should remain around 55% once the GGP deal closes. The deal will also provide BPY/BPR with considerable "scale advantages" as illustrated below:

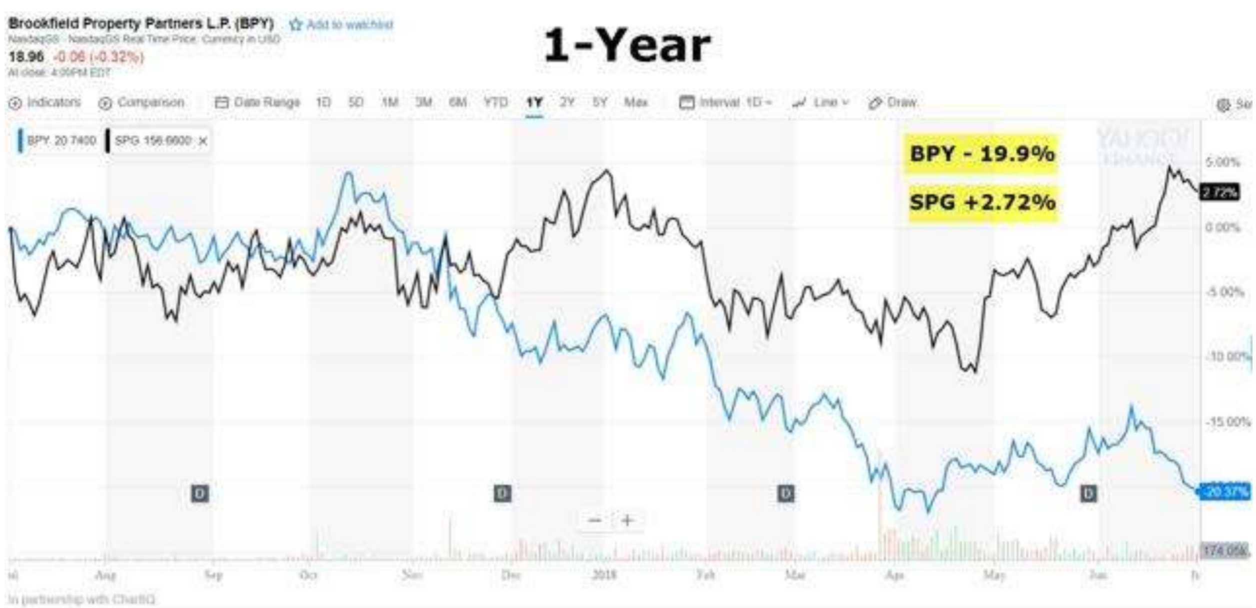
How To Play It?

As noted above, BPY is an L.P., so I have not taken much time to research the company, until now. BPY shares are down approximately 20% year-to-date and shares are yielding 6.42%.



Given the price decline, BPY appears to be an attractive deal, especially considering the investment thesis:

The GGP deal will create larger public float for BPY and the transaction is immediately FFO/share accretive. The transaction provides direct access to enhance GGP's irreplaceable class A retail portfolio, and with a REIT vehicle it's certain to offer a simplified ownership structure (1099's). Here's how BPY has performed in relation to **Simon Property Group** (SPG) over the last 12 months:



It appears that the new REIT, Brookfield Property REIT, could become an interesting play, and I'm glad that BPY recognizes the difficulty (for IRAs) of owning shares in a Bermuda L.P. BPR could become a cutting edge move for Brookfield to capitalize on the dedicated REIT investor base and I can foresee the potential for BPR to further consolidate BPY trophies, including the Rouse Mall portfolio.