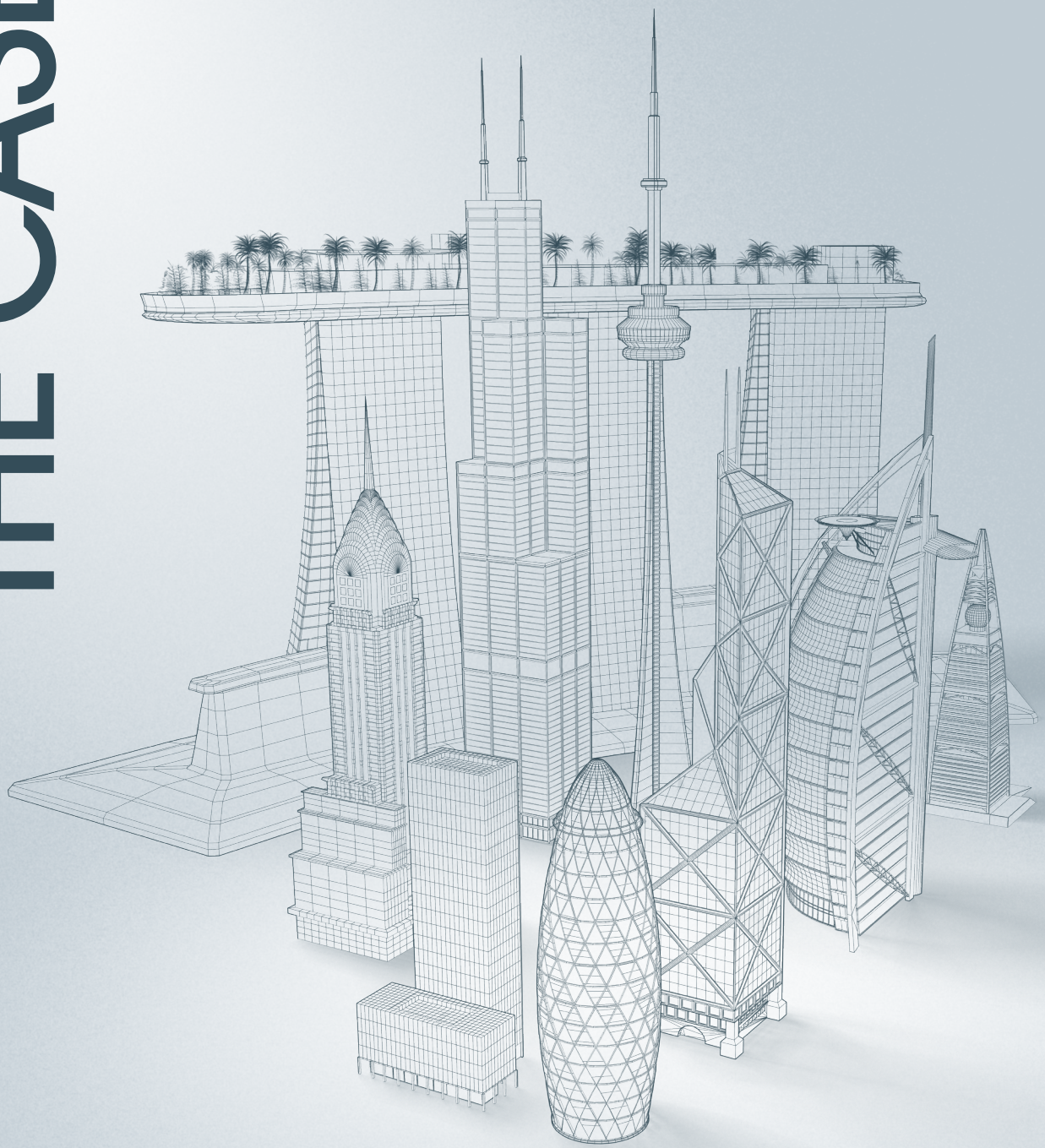
THE CASE FOR

Janus Henderson
KNOWLEDGE. SHARED

Global Property Equities



The Case for Global Property Equities

Published July 31, 2018

Listed real estate stocks including real estate investment trusts (REITs) have the potential to offer investors a liquid, low cost and transparent way to invest in property. Over the long term, returns from listed real estate have exceeded those from direct (physical) real estate. The Janus Henderson Global Property Equities Team believes an active, selective and focused approach is capable of delivering attractive returns to investors.

The Case for Investing In Property Equities

1) Potential for listed real estate to increase returns and decrease risk in a balanced portfolio

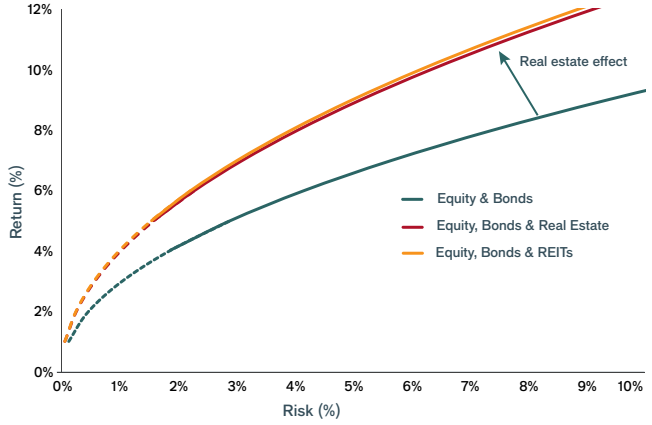
Over the long term, returns from listed real estate have exceeded those from direct (physical) real estate[1]. While the compromise in the short term tends to be greater volatility, this is often more than offset in the longer term by the higher returns and higher liquidity compared to investing in direct real estate. Exhibit 1 shows that adding property equities to a diversified portfolio is capable of enhancing returns without increasing risk. Additionally, as many listed real estate stocks currently trade at a discount to the private market value of their assets[2], it generally remains cheaper to access property through the listed sector.

[1]Source: European Public Real Estate Association (EPRA). Global listed real estate 9.5% versus global physical real estate 7.4%, 15 years annualized total returns to June 30, 2018.

[2]Source: UBS, data from March 2003 to June 2018. FTSE EPRA/NAREIT Global Index.

Exhibit 1: Effect of Adding Property Equities to a Balanced Portfolio

Source: Janus Henderson Investors, European Public Real Estate Association



(EPRA), Bloomberg as of June 2018. The efficient frontier shows the minimum variance portfolio (or least risky portfolio) for a given rate of return. The resulting line shows the most efficient portfolio for any given combination of risk and return. Rational investors will construct portfolios that have risk-return profiles that are located on this frontier. The efficient frontiers are calculated using data from a rolling 10-year period from June 30, 2008, to June 29, 2018.

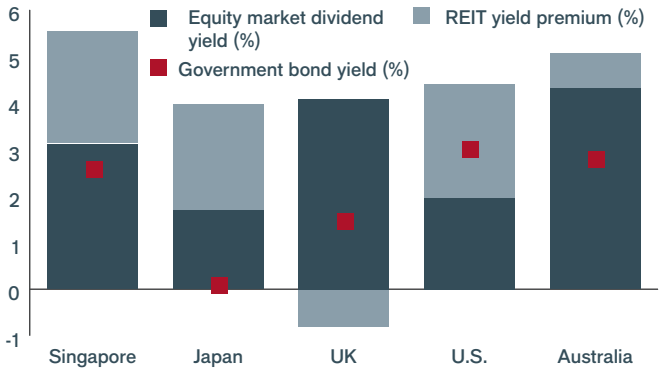
2) High current dividend yield with consistent growth

The listed property sector offers investors an attractive income proposition, characterized by consistent earnings and dividend growth. Over the long term, reinvested dividends have accounted for around two-thirds of global REIT returns.

Source: Bloomberg. FTSE EPRA/NAREIT Global Total Return Index January 1, 1999, to June 29, 2018.

REITs offer an attractive income return compared to major government bond yields and the wider equity market (see Exhibit 2).

Exhibit 2: Global REITs Offer Higher Dividend Yields than Government Bonds and Most Global Equities



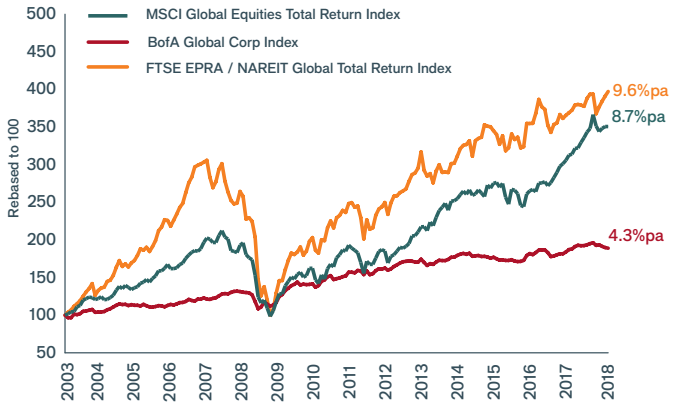
Source: UBS, Bloomberg as of June 30, 2018. 10-year government bonds.

Listed real estate can also offer predictable cash flow growth as many lease contracts feature rents indexed to grow annually with inflation. A strong economy also leads to increased demand for space and lower vacancies, allowing landlords to increase rents as many leases mature. This cash flow growth supports REIT dividends, which have consistently grown in excess of inflation.

3) Favorable risk-adjusted returns versus general equities and bonds

Over the longer term, listed property has delivered higher returns (Exhibit 3) and lower correlation compared to general equities and fixed income alternatives. The sector's attractive and differentiated return profile comes from a combination of a high starting yield, inflation-linked earnings growth, and price appreciation from a real physical asset.

Exhibit 3: Listed Property Returns vs. Global Equities and Bonds



Source: Bloomberg MSCI, S&P Citigroup, as of June 30, 2018

Note: Total return indices in USD, rebased to 100 on June 30, 2003.

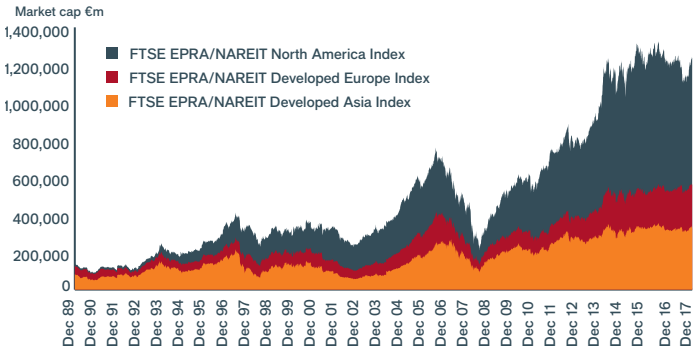
4) Accessible diversification of high-quality real estate

The listed property sector enables investors to benefit from global ownership of high-quality real estate assets with professional management platforms and daily liquidity. Key attributes of listed property such as property sector and geographic diversification, transparent disclosures and daily pricing are not generally available through other forms of real estate ownership.

The listed property sector has seen significant growth as high-quality companies come to market and existing businesses have leveraged their operational expertise. This fact was recognized when real estate was added as a unique Global Industry Classification Standard (GICS) sector in 2016. A larger, more liquid sector provides more opportunities for active investors as well as potential for additional earnings growth for companies through economies of scale.

Despite this growth, only around 10% of commercial real estate assets are currently held by listed public companies as as of March 31, 2018, according to the European Public Real Estate Association (EPRA). As a result we believe the listed property sector is set for many years of structural growth ahead (Exhibit 4).

Exhibit 4: Listed Real Estate Sector: Still Growing



Source: Bloomberg, as of June 30, 2018

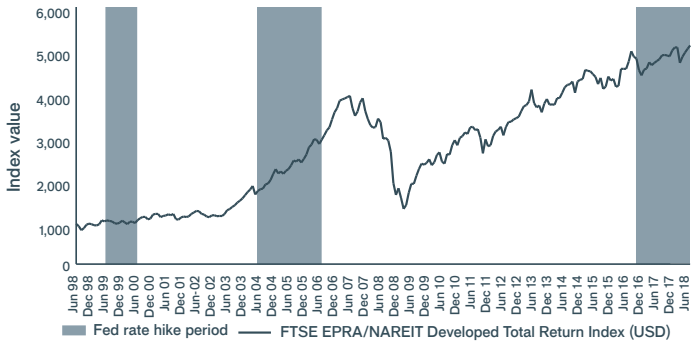
Index: FTSE EPRA/NAREIT Developed Real Estate Total Return Indices

Reasons why We Believe Investors Should Consider Investing in Listed Property Now:

1) REITs are not bonds – the potential for cash flow grows

Real estate's performance has recently been negatively affected by the perception that the asset class is disproportionately harmed by rising interest rates. In fact, history has shown that REITs can continue to offer attractive returns to investors in periods of gradually rising rates (Exhibit 5). An important driver of this resiliency has been REITs' historical average earnings growth of around 5% per annum over the past 15 years to June 30, 2018. (Source: UBS Real Estate Research). Commercial real estate owners are landlords to the economy; as economic output increases, typically so do rents.

Exhibit 5: Global Listed Real Estate Performance

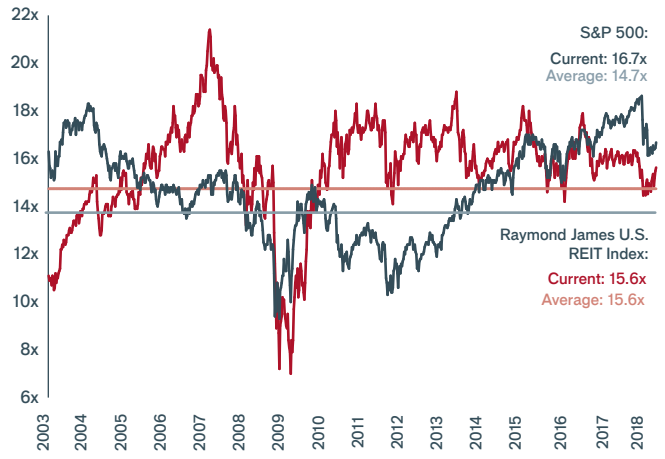


Source: FTSE, U.S. Federal Reserve, data to June 30, 2018. Index rebased to 1,000 as of June 30, 1998. The gray shading illustrates all periods from when the Federal Reserve initially increases interest rates to when they eventually stopped increasing in each period.

2) Listed real estate is now historically cheap

As an example, U.S.-listed real estate has underperformed broader equity markets in recent years. Not only has this lead to attractive income opportunities but it also left REIT earnings multiples at a discount versus other sectors. On a price-to-earnings (P/E) multiple basis, U.S. REITs are, on average, currently trading at a discount to broader equities compared to their historical premium (Exhibit 6).

Exhibit 6: REIT Valuations now Attractive vs. Broader Equities

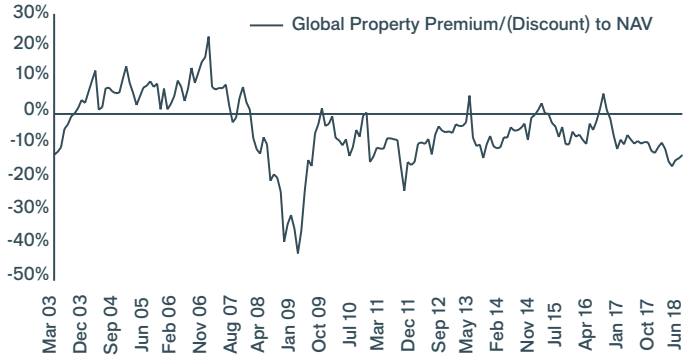


Source: FactSet, Raymond James, data as of June 8, 2018. S&P 500 Index multiple = price-to-earnings ratio. Raymond James U.S. REIT Index multiple = P/FFO = price-to-funds from operations, which is used to estimate a REIT's present value and future ability to pay dividends.

3) Public real estate is cheaper than private markets

A key metric for the valuation of the sector is where listed property companies trade relative to the private market value of underlying property owned by the companies (their net asset value or NAV). Since 2017 the global REITs has traded at average discounts to estimated private market net asset value of approximately .10%-15% globally (Exhibit 7). While a discount to NAV may be warranted in a period of slowing NAV growth, this current discount may be an attractive entry point, given the ability to buy assets cheaper on "Wall Street" than on "Main Street." Furthermore, a persistent NAV discount can potentially trigger more mergers and acquisitions in the sector, as seen in recent years.

Exhibit 7: Global Property Markets now Trading at Discounts to NAV



Source: UBS, data from March 2003 to June 2018. FTSE EPRA/NAREIT Global Index.

Summary

In our opinion, the underlying fundamentals for the global listed property sector remain robust and investor demand for physical real estate, a real asset with an attractive and growing income stream, remains healthy.

While further rises in interest rates and bond yields are possible, as global growth picks up and central bank policy becomes less accommodative, the current spread between property and bond yields remains wider than its historical average. This makes sense given equity markets are forward looking and decisions to raise interest rates are based on backward-looking economic data.

The key risk to this base case is that stronger-than-expected economic growth causes the long end of the yield curve to rise more sharply. This would be negative for the asset class. However, the team believes that longer-term trends in demographics, technology disruption and debt may keep rates lower going forward.

Against this backdrop, an active and selective approach enables the Janus Henderson Global Property Equities Team to continue to find attractive investment opportunities within the listed property sector. The focus remains on companies capable of growing income and dividends and those best placed to benefit from technological advances, which are changing consumer behaviors and altering the needs and uses for real estate.

Opportunities for active managers

The Janus Henderson Global Property Equities Team's fundamental belief is that identifying long-term growth within real estate markets is key. For example, technological advances have fundamentally changed consumer behaviors and altered the needs and uses for real estate. This creates opportunities for active managers. The team invests in more than REITs; the broad investable universe is not defined by an index. More than 500 real estate companies are covered globally with team members based in London, Singapore and Chicago. These may include off-benchmark securities, such as companies focused on fast-growing "alternative" sectors such as data centers, cell towers, and manufactured housing. The eight-member-strong team's deep investment expertise offers investors investment opportunities not available through ETFs (exchange-traded funds) or some other global property equity strategies.

For more information, please visit **janushenderson.com.**

Janus Henderson
INVESTORS

The opinions and views expressed are as of the date published and are subject to change without notice. They are for information purposes only and should not be used or construed as an offer to sell, a solicitation of an offer to buy, or a recommendation to buy, sell or hold any security, investment strategy or market sector. No forecasts can be guaranteed. Opinions and examples are meant as an illustration of broader themes and are not an indication of trading intent. It is not intended to indicate or imply that any illustration/example mentioned is now or was ever held in any portfolio. Janus Henderson Group plc through its subsidiaries may manage investment products with a financial interest in securities mentioned herein and any comments should not be construed as a reflection on the past or future profitability. There is no guarantee that the information supplied is accurate, complete, or timely, nor are there any warranties with regards to the results obtained from its use.

Past performance is no guarantee of future results. Investing involves risk, including the possible loss of principal and fluctuation of value.

Foreign securities are subject to additional risks including currency fluctuations, political and economic uncertainty, increased volatility, lower liquidity and differing financial and information reporting standards, all of which are magnified in emerging markets.

FOR MORE INFORMATION CONTACT JANUS HENDERSON INVESTORS

151 Detroit Street, Denver, CO 80206 | www.janushenderson.com

C-0818-18812 08-30-19

688-15-418812 08-18