A solution for high correlations and heightened volatility

Publicly traded and private real estate offer diversification and stability

Tighter correlations between traditional asset classes and increasingly volatile equity markets have left investors searching for solutions that add meaningful diversification and stability to their portfolios. Real estate, whether private or public, stands out among the available options that can deliver what investors are looking for.

Low correlations

Global real estate has an attractive 0.36 correlation to global bonds, and a 0.77 correlation to global equities.[1] The latter figure appears high, but it doesn't tell the whole story. Consider the more nuanced picture presented in Figure 1 below.

Correlation with equity markets

Figure 1: Real Estate / Equity Regional Correlations

Real Estate / Equity Regional Correlations							
	U.S.	Canada	Europe	Hong Kong	Japan	Singapore	Australia
U.S.	0.56	0.44	0.45	0.36	0.32	0.45	0.49
Canada	0.50	0.52	0.39	0.36	0.28	0.46	0.44
Europe	0.53	0.44	0.57	0.38	0.41	0.50	0.53
Hong Kong	0.52	0.54	0.43	0.89	0.30	0.72	0.51
Japan	0.35	0.28	0.35	0.26	0.76	0.32	0.39
Singapore	0.52	0.51	0.44	0.70	0.33	0.84	0.48
Australia	0.42	0.39	0.41	0.33	0.28	0.35	0.26

Source: Bloomberg. Data as of December 31, 1992 to March 31, 2019

Overall, correlations between global real estate and equities are low; there are only a handful of areas – focused in Asia – where correlations spike. For example, Hong Kong real estate is highly correlated to its local equity market. The same is true of Japan and Singapore. Conversely, Canadian real estate has a low correlation to its local equity market, with the same being true of the U.S., Europe and Australia. In addition, correlations between specific real estate markets and foreign equity markets are, with few exceptions, markedly low.

Skilled active management can counteract the few instances of elevated correlations. Underweighting those markets, and overweighting markets that have low correlations to equity markets, will tend to bring down the overall correlation to equities.

Low correlations are also observed within global real estate. Canada's real estate market has a 0.56 correlation to U.S. real estate, 0.53 to Europe, 0.34 to Hong Kong, 0.28 to Japan, 0.39 to Singapore and 0.53 to Australia.

A private equity allocation consists of direct investments in real estate (bricks-and-mortar investments) and privately held companies that primarily own real estate. As an active investor, Timbercreek's focus is on investments where value can be created by improving net operating income (e.g., through renovations or recapitalization) or the overall quality and competitiveness of the property.

PRIVATE DEBT: STABLE INCOME

A private debt exposure involves direct investments in debt that's secured by real estate or issued to companies that focus on real estate. The aim of the portfolio manager should be to identify opportunities that generate more yield than would normally be expected for the level of risk undertaken. Timbercreek's focus is on shorter-duration mortgage loans to protect invested capital in a rising interest rate environment.

PUBLIC EQUITY: STRONG RETURNS WITH HIGH LIQUIDITY

This is the most liquid form of real estate investing, targeting common equities of publicly traded issuers backed by real estate, such as REITs. Investing in REITs provides a diversified exposure to real estate assets. Timbercreek targets both income and opportunistic growth with the aim of generating substantial returns.

PUBLIC DEBT: STABLE INCOME AND LIQUIDITY

A public debt exposure includes investments in publicly traded preferred stock, unsecured debt, convertible debentures, preferred equity of REITs and mortgage REITs. Timbercreek targets undervalued securities to generate outsized returns. As with private debt, Timbercreek is looking for securities with yields that are greater than would be expected given their risk levels.

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