Q3
2014

Global Market Update

AEW Real Estate Securities

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MARKET REVIEW

As shown in U.S. dollar terms in the tables below, global property securities, as measured by the UBS Global Real Estate Investors Index, declined by 4.1% on a total return basis in the third quarter of 2014, bringing the year-to-date return to 11.1%. Asia Pacific was the top-performing region for the quarter, while North America was the best performer for the year-to-date and trailing twelve months. Europe led the way for the three-year trailing period ended September 30, while North America had the best annualized performance for the five-year trailing period. Volatility within the UBS Investors benchmark has been somewhat lower in Asia Pacific than in the other regions over the past ten years.

During the third quarter, the UBS Global Investors Index outperformed the FTSE EPRA/NAREIT Developed Index by 28 basis points. (The FTSE EPRA/NAREIT Developed Index is essentially the sum of the UBS Investors and UBS Developers; most of the Developers are in Asia ex-Australia.) Year-to-date, the UBS Global Investors Index outperformed the FTSE EPRA/NAREIT Developed Index by 392 basis points given the poor showing by Developers in the first three quarters of the year. The annualized returns of the UBS Global Investors benchmark were also greater than those of the FTSE EPRA/NAREIT Developed benchmark over the one-, three-, and five-year trailing periods. On a rolling ten-year basis, the Developers have experienced higher volatility than the Investors, but the covariance of the returns has been such that the overall volatility of the FTSE/EPRA NAREIT Developed Index has been similar to that of the UBS Global Investors Index.

UBS Global Real Estate Investors Index (USD)

Periods Ended 9/30/14	3rd Qtr Total Return	YTD Total Return	1-Year Total Return	3-Year Total Return(1)	5-Year Total Return(1)	10-Year Volatility
North America	-3.20%	14.22%	12.99%	16.14%	15.78%	25.36%
Europe	-7.60%	5.87%	12.05%	16.20%	9.10%	24.34%
Australia	-6.28%	11.59%	5.09%	14.90%	8.47%	25.08%
Asia	-2.65%	6.35%	1.28%	14.25%	12.57%	18.23%
UBS Investors	**-4.15%**	**11.15%**	**10.04%**	**15.74%**	**12.99%**	**21.93%**

Source: Bloomberg, UBS.
[1]Annualized

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FTSE EPRA/NAREIT Developed Index (USD)

Periods Ended 9/30/14	3rd Qtr Total Return	YTD Total Return	1-Year Total Return	3-Year Total Return[1]	5-Year Total Return[1]	10-Year Volatility
UBS Investors	-4.15%	11.15%	10.04%	15.74%	12.99%	21.93%
UBS Developers	-4.85%	-10.65%	-10.84%	17.49%	5.99%	26.83%
EPRA/NAREIT	**-4.43%**	**7.23%**	**6.71%**	**15.63%**	**11.26%**	**21.36%**

Source: Bloomberg, UBS, EPRA.

[1]Annualized

REGIONAL COMMENTS

In North America, the news on the property front has continued to be quite positive, with most changes, good or bad, being just a matter of degree. Driven first and foremost by underlying property fundamentals, and enhanced by a positive financing environment and a varying amount of external growth activity, U.S. REIT per-share cash flow is expected to grow 8% or more in 2015 and 2016. It is this potential for growth that has always differentiated property and REITs from most alternatives in the broadly defined group of "yield plays." Moreover, a continuing flood of capital from a variety of domestic sources as well as from offshore has resulted in an active -- and deep -- property transactions market, and property valuations continue to grow. REITs already trade at a small discount to underlying NAVs (net asset values), and the continuing strength in the private real estate market bodes well for continued support for REIT NAVs. Beyond offering this tangible valuation framework, the strength in the private real estate market does come with both negative and positive implications for various REITs. The biggest drawback is that net new acquisitions are generally less attractive than usual for most REITs. On the other hand, many REITs have been actively repositioning (i.e., upgrading) their portfolios by selling lower-quality assets into a very strong bid. While companies in all sectors have taken steps in this manner, nowhere has this trend been more evident than in the regional mall sector, where companies such as Simon, Taubman, General Growth, Westfield, and Macerich have either sold or spun off significant amounts of "C" assets in 2014 and before. For those companies with meaningful development talents and pipelines, the strong investment market has actually been the stuff of dreams. As fortunate as it is today to own golden eggs, it is absolutely wonderful to be able to create more golden eggs. Certain companies (such as Boston Properties, Kilroy Realty, and AvalonBay to name a few beneficiaries of the environment) are generating big increases in NAVs and future cash flows by an ability to deliver new assets worth 30-50% more than their cost and at yields 150-250 basis points higher than what is available in the acquisition market. Trends in the amount of new development (i.e., new supply) are of course worth monitoring given the success noted above. As the private market strength continues, one would naturally expect an increase in the overall amount of new supply. For the time being, however, new construction in most sectors is still well below historical norms.

In Europe, REITs slightly lagged the general equity market. The share prices of the property equities with exposure to German residential were amongst the strongest performers in the third quarter, while companies with exposure to Russia were amongst the weakest. Overall, the economic indicators in the Euro-zone continue to be weak, and at this point in time, it is still uncertain if the actions the European Central Bank (ECB) has taken to support the banks will revive its economies. One positive catalyst could be that the Euro has declined by around 7% against the U.S. dollar in the last few months, which will be positive for the export market. Additionally, it is possible that the ECB will start a quantitative easing program whereby it will buy securities on the market directly from the public. These actions have been taken by the Bank of England, Federal Reserve, and Bank of Japan in recent years with a positive effect on both the securities markets and economies. The economies in Sweden and the United Kingdom are performing well, and the Bank of England will likely start hiking interest rates modestly next year. Looking ahead, the political and economic environment in Europe has deteriorated in the last few months, as the Russian invasion of the Ukraine has led to geopolitical tensions. The economic environment in the Euro-zone continues to show weakness, and in the U.K., there is political uncertainty with upcoming elections in 2015. On the other hand, these developments will probably lead to low interest rates for a longer time, which is a positive for real estate. The investment market of European real estate continues to be very strong. Overall, European REITs are trading at a 3% premium to net asset values. The European REITs offer an attractive, relatively low risk and growing earnings yield of 4.9%, and the dividend yield is 3.8%.

In Asia Pacific, currency had a big impact to U.S dollar performance in the third quarter with all currencies weakening against the U.S dollar. In particular, the Australian dollar and Japanese yen depreciated 7.7% and 7.3%, respectively. In Australia, the AREITs reported their semi-annual results during the third quarter, and most AREITs reported in-line with expectations and provided positive earnings guidance. In Japan, developers underperformed as the market was concerned with increasing construction costs, while the JREITs benefited from the compression of the 10-year Japanese Government Bond yield. The Hong Kong property stocks posted positive performance; however, the market underwent a 3.4% correction in the last two days of the quarter following the weekend of the pro-democracy protests, “Occupy Central”. We believe Occupy Central will have a bigger negative impact on the landlords than the developers in the near term given that business operations will be disrupted and that Chinese authorities' have suspended tour groups to Hong Kong, which will be a negative for tourism and retail sales, especially since Mainland China tourists account for 75% of total visitors to Hong Kong, (although about 67% visit the city as individual travelers). In Singapore, developers underperformed the REITs, as residential market transactions remained lackluster, whilst the government's stance that it was premature to relax property cooling measures dampened investor sentiment. Overall, Asia Pacific REITs and property developers are trading below our fair valuation, with the exception of JREITs, which are trading at a premium. Demand for assets continues to be robust across the region, driving further compression in cap rates. Whilst we are not anticipating further material declines in cap rates as we move a step closer to the probability of rate hikes, forecast commercial supply over the next four years is largely below historical average demand. Hence, we expect positive net absorption of commercial space and an improvement in vacancies and rents to support capital values. Balance sheets of companies are generally in good shape with companies increasingly fixing their debt costs and diversifying their debt maturity profiles. We expect currency risk to be a likely headwind to U.S. dollar returns for the region with both the Australian dollar and Japanese yen expected to remain weak.