Real Estate GICS Sector

SEPTEMBER 2015

REAL ESTATE WILL OBTAIN ITS OWN GICS CLASSIFICATION IN 2016

The Global Industry Classification Standard (GICS) is an investment classification structure developed by MSCI and Standard & Poor's that is commonly used by investment professionals globally to classify public companies into ten distinct sectors. Currently, REITs fall within the Financials sector, which also includes Banks, Diversified Financials, and Insurance. S&P and MSCI have announced that effective August 31, 2016, Real Estate will become the eleventh GICS sector. With the exception of Mortgage REITs, which will remain with Financials, Equity REITs will be combined with Real Estate Management & Development securities to form the newly created Real Estate sector.

There will be a total of approximately 2,600 companies in the Real Estate GICS sector, comprised of more than 700 companies in the Equity REITs category and nearly 1,900 companies in the Real Estate Management & Development category. By market cap, each category will comprise roughly half of the newly formed Real Estate sector with a total market cap of nearly $3 trillion. We believe the new GICS classification for real estate is potentially a long-term positive for REITs for a number of reasons including: increased investor interest in Equity REITs; a decrease in REIT correlations with Financials and other equities; and a decrease in REIT volatility.

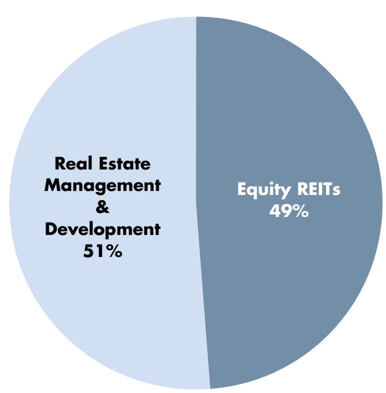
Real Estate GICS sector classification may increase investor interest in REITs, decrease REIT correlations with financials and decrease REIT volatility.

Real Estate - The 11th GICS Sector

Real Estate		
Equity REITs		**Real Estate Management & Development**
Diversified REITs	Health Care REITs	Diversified Real Estate Activities
Industrial REITs	Residential REITs	Real Estate Operating Companies
Hotel & Resort REITs	Retail REITs	Real Estate Development
Office REITs	Specialized REITs	Real Estate Services

Source: MSCI and Standard & Poor's

GICS Real Estate Sector by Market Capitalization



Calculated as of September 24, 2015
Source: MSCI, Standard & Poor's, Bloomberg

INCREASED INVESTOR INTEREST AND HEIGHTENED AWARENESS OF REIT FUNDAMENTALS

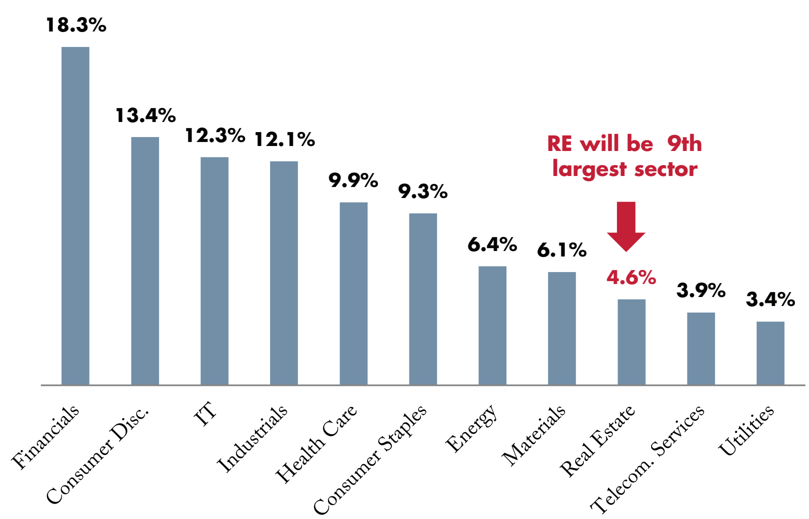
Historically, real estate has been included with Financials, despite the sector's distinctly different investment characteristics. REIT fundamentals are different from the rest of the Financials sector, and analysts and investors typically use a different set of metrics to value REITs. For example, when comparing where REITs are trading on a historical multiple basis, investors and analysts typically (if they are familiar with the REIT sector and its nuances) estimate Adjusted Funds From Operations (AFFO) rather than evaluating the P/E multiple that is more commonly used for general equities. Many investors, however, simply compare P/E ratios and decide REITs are expensive compared to other sectors due to their higher P/E ratios. Anecdotally, our understanding is that generalist equity investors have been underweight REITs for years, either because they have been hidden within Financials or because they do not understand the sector. Elevating Real Estate to a headline sector should help to focus attention on REITs as a distinct and unique asset class and may attract more investors to the sector over time.

With the revised 2016 GICS definitions, Real Estate will be ninth largest GICS sector.

With the revised 2016 GICS definitions, Real Estate will become the ninth largest GICS sector, comprising nearly 5% of total market cap using 2015 estimates. As a result, investors that have an allocation to Financials, but not to real estate, may decide to make an allocation to the new sector or, at the very least, may re-think their zero allocation.

GICS Sectors Adjusted for 2016 Definitions

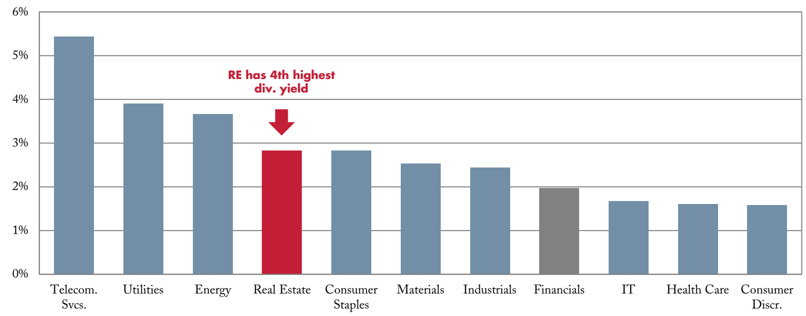
% Market Capitalization*



**As of September 24, 2015*
Source: Bloomberg, AEW

REITs also have dividend yields that are higher than Financials and above-average compared to other GICS sectors. For example, as of late September, REITs had an average dividend yield of 3.7%, while Real Estate Management & Development companies had an average dividend yield of 1.9%. If separated from Financials, the Real Estate GICS Sector would have a combined dividend yield of 2.8%, the fourth highest yield of the GICS sectors and higher than the Financials average dividend yield of 1.9% (adjusted to exclude Real Estate). Going forward, the new Real Estate sector may attract more yield-driven investors and better highlight the hybrid characteristics unique to REITs.

Dividend Yields by GICS Sector Adjusted for 2016 Definitions

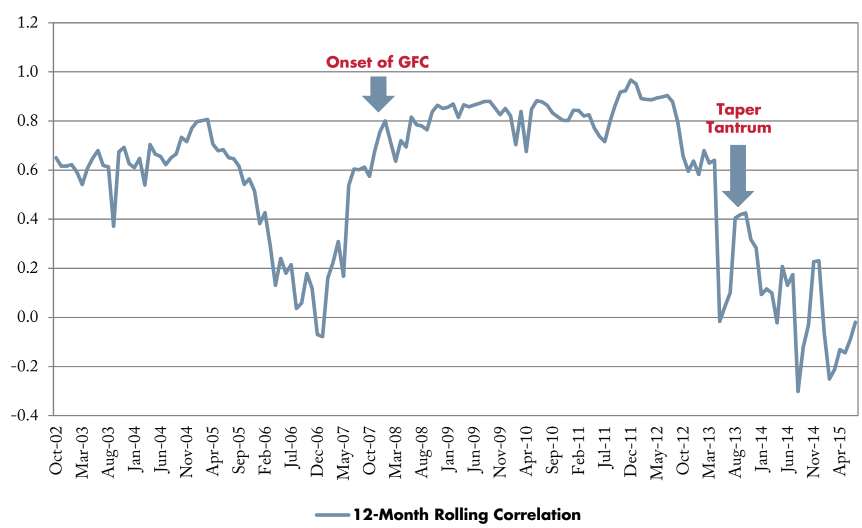


As of September 24, 2015
Source: Bloomberg, Dow Jones, AEW

LOWER CORRELATIONS WITH FINANCIALS AND LOWER VOLATILITY IN THE EVENT OF A FINANCIAL CRISIS

Creating the separate GICS sector for real estate could lower REIT correlations with Financials, as well as limit volatility in the event of another financial crisis. Correlations rose during the Global Financial Crisis and briefly jumped again following the Federal Reserve's announcement that it would eventually begin winding down its bond purchase program (i.e. the withdrawal of "QE3" and the subsequent "Taper Tantrum"). REIT companies typically employ 30-40% leverage, while it is not uncommon for the rest of the sector (Insurance, Banks, and Diversified Financials) to lever up by multiples. As a result, lumping REITs in with Financials disregards REITs' distinctly lower debt ratio that is backed by real assets as collateral. Once Real Estate becomes a separate sector in 2016, returns may become less correlated with Financials, and volatility may decline.

Financials vs. REITs

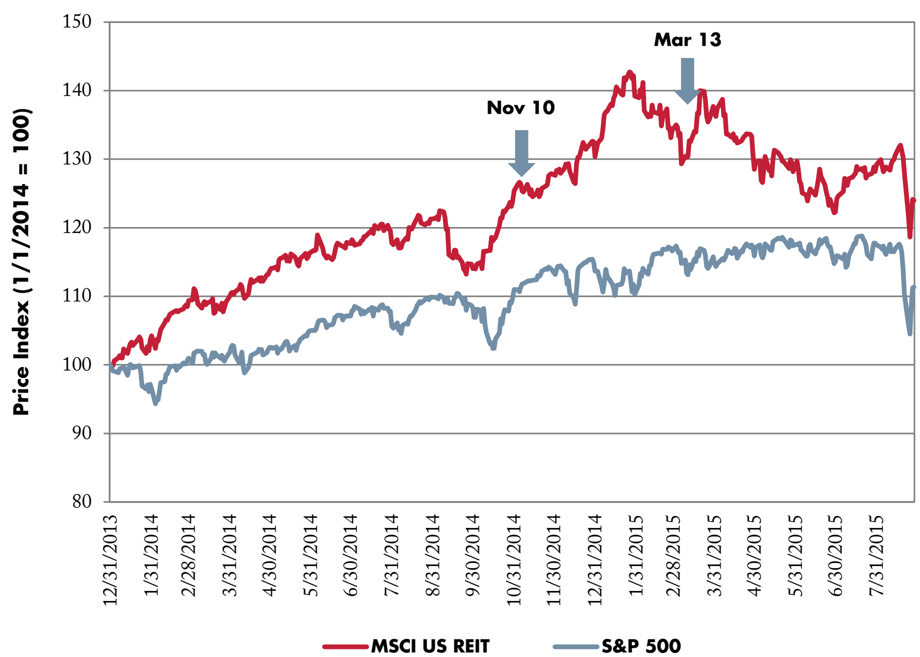


Source: Bloomberg, AEW

SHORT-TERM EFFECTS OF THE NEW GICS SECTOR

While there may be some short-term noise around the transition in August 2016 due to rebalancing, this will likely be short-lived, and the new headline sector status should be a positive for listed real estate over the medium- and long-term. Thus far, investor reaction has been mixed regarding the creation of the Real Estate sector. In the five days following the initial announcement on November 10, 2014, the MSCI US REIT Index returned -0.6% and lagged the S&P 500 by 100 basis points. However, the MSCI returned nearly 3.0% and outperformed general equities by 180 basis points in the five days following the confirmation of the separate sector (March 13, 2015 after accepting public comments).

Trading Following GICS Announcements



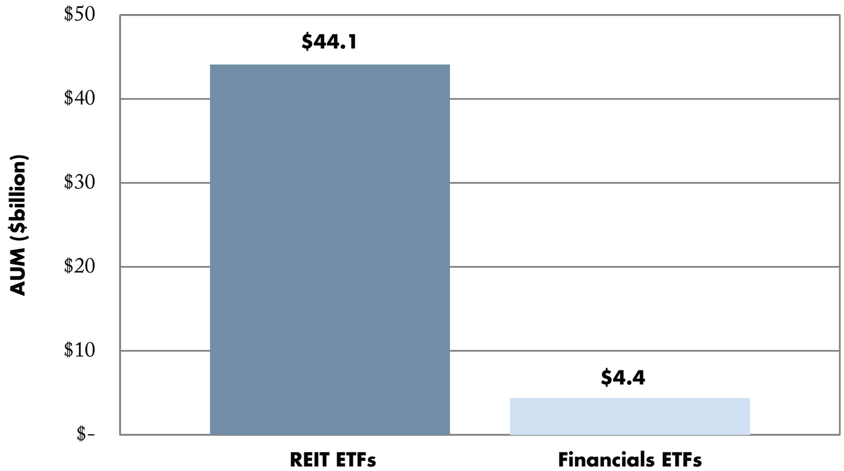
Source: Bloomberg, AEW

Short-term volatility from passive investors is expected to be limited as the REIT market cap within Financials exchange-traded funds (ETFs) is dwarfed by existing Real Estate ETFs. Currently, there are 36 Real Estate ETFs, which hold roughly $44 billion in REIT assets. Meanwhile, there are 35 Financials ETFs, and 19 of these funds include an average allocation of 20% to REITs for a total of $4.4 billion in REIT assets. As the 2016 GICS revision approaches, these ETFs will either sell out of their real estate holdings, spin off their real estate holdings into separate ETFs, or continue to keep the Real Estate sector lumped in with Financials. For example, Financial Select Sector SPDF Fund (ticker: XLF), the Financials ETF that owns the largest amount of REIT assets (more than $2.7 billion), announced that it will continue to include both REITs and non-REIT Financials in the Fund. They will also create two new ETFs using the holdings of the XLF Fund – one ETF that tracks the new Real Estate sector and one ETF that tracks the new Financials sector[1]. Overall, the demand for Real Estate ETFs may increase upon the creation of the GICS sector; however,

[1]Conversation with Bryan Paone at State Street Global Advisors on September 22, 2015.

ETFs appear to be ahead of the GICS implementation given the large amount of assets already dedicated to the real estate sector. We should have greater clarity on how Financials ETFs will handle their REIT exposure in the months leading up to the GICS change in 2016.

REIT Holdings Within ETFs



As of September 15, 2015
Source: ETF.com, Bloomberg, AEW

Exchange-Traded Funds (ETFs) That Include REITs				
Financials ETFs	**Ticker**	**Total Assets ($billion)**	**Allocation to REITs**	**REIT Assets ($billion)**
Financial Select Sector SPDF Fund	XLF	17.79	15.3%	2.73
Vanguard Financials ETF	VFH	3.08	21.5%	0.66
iShares U.S. Financials ETF	IYF	1.49	19.1%	0.28
Direxion Daily Financial Bull 3x	FAS	1.21	17.1%	0.21
ProShares Ultra Financials	UYG	0.73	19.8%	0.14
First Trust Financials AlphaDEX Fund	FXO	0.88	15.0%	0.13
PowerShares KBW High Dividend Yield Financial Portfolio	KBWD	0.28	42.5%	0.12
PowerShares S&P SmallCap Financials Portfolio	PSCF	0.17	31.7%	0.05
Guggenheim S&P Equal Weight Financial ETF	RYF	0.19	28.2%	0.05
Fidelity Financials ETF	FNCL	0.23	21.9%	0.05
iShares Global Financials ETF	IXG	0.26	12.0%	0.03
PowerShares DWA Financial Momentum Portfolio	PFI	0.03	43.1%	0.01
SPDR S&P Capital Markets ETF	KCE	0.14	1.9%	0.00
RevenueShares Financials Sector Fund	RWW	0.03	4.8%	0.00
ProShares UltraPro 3x Financials	FINU	0.01	3.5%	0.00
ProShares UltraPro Short Financials	FINZ	(0.01)	19.8%	(0.00)
ProShares Short Financials	SEF	(0.02)	19.8%	(0.00)
ProShares UltraShort Financials	SKF	(0.06)	19.8%	(0.01)
Direxion Daily Financial Bear 3x	FAZ	(0.32)	17.1%	(0.05)
Total				**$4.41**

As of September 15, 2015
Source: ETF.com, Bloomberg, AEW

CONCLUSION

Overall, AEW believes that the new Real Estate GICS classification is positive as it has the potential to increase investor interest in REITs; decrease correlations with Financials and other equities; and decrease volatility. Generalist equity investors have traditionally been underweight REITs, either because they have been hidden within Financials or because they do not understand the sector. Elevating Real Estate to a headline sector should help heighten attention on REITs as an asset class and may attract more investors to REIT investing over time. While there may be some short-term noise around the transition in August of 2016 due to rebalancing, this will likely be limited and short-lived, and the new headline sector status should be a positive for listed real estate over the medium- to long-term.

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