

North America Strategy

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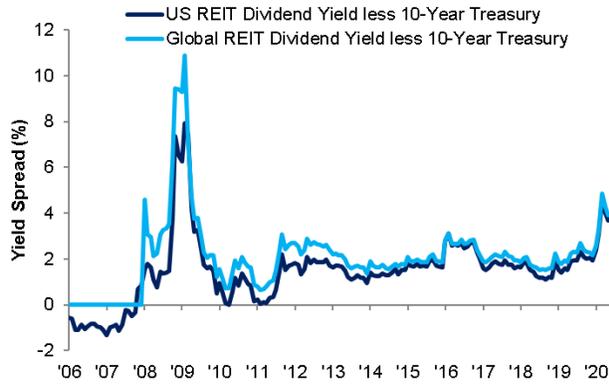
Equity Sector Update: Upgrading REITs

- [We are upgrading REITs to overweight given their well-valued income generating capacity, prospects for relative growth and catch-up potential as the economy recovers from the COVID-related recession.](#)
- The yield spread between REITs and Treasuries was only greater in the Financial Crisis (Figure 1) and analysts peg REITs as having twice the long-term earnings growth of traditional bond proxies (Figure 2).
- Unlike Utilities, REIT yields are at the high end of their historical range (Figure 3). We believe this provides a margin of safety should soft rent collections pressure the dividends of some REITs.
- Different REIT segments have experienced significant return dispersion this year (Figure 4). Cell towers (infrastructure), data centers, industrial and storage have outperformed; lodging and retail have lagged.
- As per retail, the WSJ notes that e-commerce gains made in the past four months rival those of the prior three years. Some consolidation and creative re-imagining of space lies ahead, in our view.
- Real estate has a solid performance record compared to traditionally defensive sectors in the year following ISM bottoms (including recessions) (Figure 5). Given the impact of COVID on space usage, we believe several REIT sub-sectors may behave more cyclically than they have in the past.

Sector	Equity	Investment Grade	High Yield
Communication Services	●	●	●
Consumer Discretionary	●	●	●
Consumer Staples	●	●	●
Energy	●	●	●
Financials	●	●	●
Healthcare	●	●	●
Industrials	●	●	●
Materials	●	●	●
Real Estate	●	●	●
Technology	●	●	●
Utilities	●	●	●

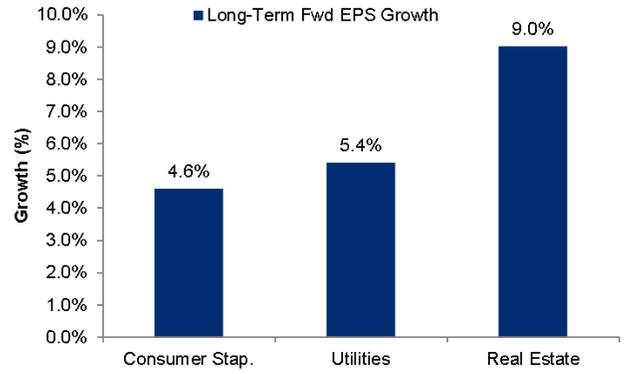
● = Overweight | ● = Neutral | ● = Underweight

Figure 1 – REITs Less 10-Year US Treasury Yields



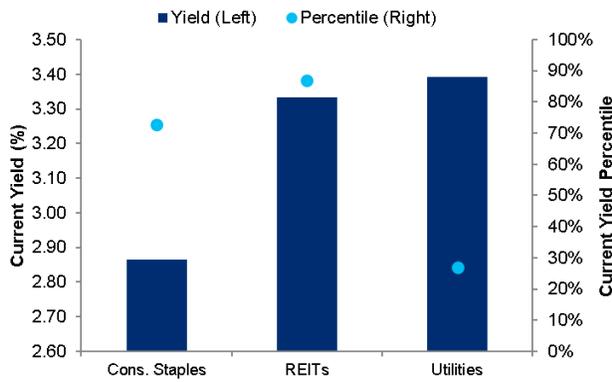
Source: Citi Private Bank (OCIS) and Factset as of June 19, 2020

Figure 2 – Bond Proxy Long-Term Growth Expectations



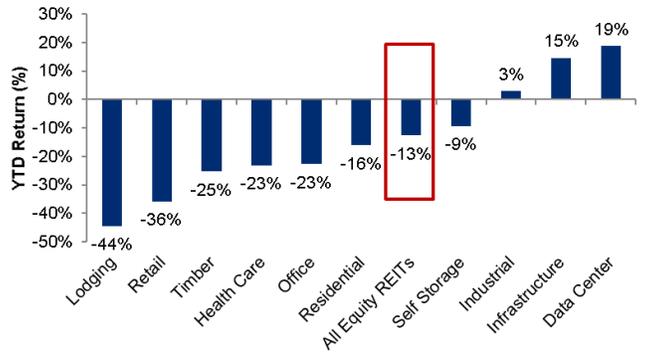
Source: Citi Private Bank (OCIS) as of June 19, 2020

Figure 3 – Bond Proxy Dividend Yields and Historical Ranges



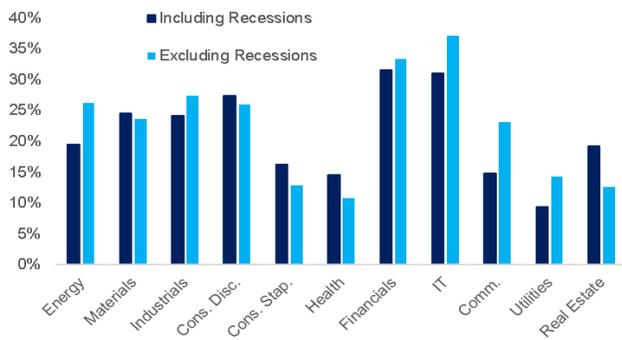
Source: Citi Private Bank (OCIS) and Factset as of June 19, 2020

Figure 4 – REIT Sub-Sector Returns



Source: Citi Private Bank (OCIS) as of June 19, 2020

Figure 5 – 1-Year S&P 500 Sector Returns after Institute of Supply Management (ISM) bottoms since 1989



Source: Factset as of May 31, 2020

Figure 5: S&P 500 Sector Earnings, P/E Ratios and Momentum: We Rely Less on These Metrics, Which Each Have a One-Third Weight in the Average Rank Column, Around Cycle Turning Points

Sector	S&P 500 Weight (%)	(1) EPS Growth 1 Year Ahead	Long-Term Fwd EPS Growth	Fwd Price to Earnings	(2) Fwd P/E Percentile	YTD Total Return (%)	(3) 9-Month Momentum	Avg Rank (1, 2, 3)
Info Tech	26.9%	8.0%	12.9%	24.2	86%	14.9%	26.4%	1
Health Care	14.4%	7.5%	9.0%	16.4	59%	-1.6%	10.9%	2
Energy	2.9%	289.9%	2.9%	-115.6	0%	-32.2%	-30.8%	3
Consumer Disc.	10.7%	20.0%	19.9%	49.6	100%	7.4%	10.4%	4
Comms Services	10.9%	3.6%	15.0%	22.3	94%	1.5%	7.1%	5
Consumer Stap.	7.0%	3.3%	4.6%	19.9	92%	-4.4%	0.5%	6
Utilities	3.1%	3.5%	5.4%	17.9	91%	-7.7%	-5.4%	6
Industrials	8.1%	9.0%	-7.8%	25.5	100%	-13.3%	-9.3%	8
Materials	2.5%	1.9%	14.6%	21.7	97%	-7.5%	-2.1%	9
Real Estate	2.9%	0.8%	9.0%	20.2	98%	-7.0%	-7.3%	10
Financials	10.5%	-2.1%	5.3%	15.1	92%	-20.9%	-13.4%	10
S&P 500	100%	2.1%	9.8%	21.9	98%	-2.7%	5.2%	

Source: Factset as of June 19, 2020; Note: Shaded circles indicate overweight (green), neutral (yellow), and underweight (red) Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only. Past performance is no guarantee of future returns. Real results may vary.

Figure 6: Largest US REITs by Category

Name	Market Cap (\$ millions)
Specialized REITs	
American Tower Corp	114,196
Crown Castle International Corp	68,868
Equinix Inc	61,651
Residential REITs	
Equity Residential	23,049
AvalonBay Communities Inc	22,561
Essex Property Trust Inc	15,892
Industrial REITs	
Prologis Inc	70,232
Duke Realty Corp	13,472
Retail REITs	
Realty Income Corp	21,769
Simon Property Group Inc	21,696
Regency Centers Corp	7,887
Health Care REITs	
Welltower Inc	23,300
Healthpeak Properties Inc	15,072
Ventas Inc	14,680
Office REITs	
Alexandria Real Estate Equities Inc	21,483
Boston Properties Inc	14,734
Vornado Realty Trust	7,652

Source: Bloomberg as of June 19, 2020. Note: For illustrative purposes only. This is neither a solicitation to buy nor a recommendation to sell any of the aforementioned securities.

Asset Allocation Definitions

Asset classes	Benchmarked against
Global equities	MSCI All Country World Index, which represents 48 developed and emerging equity markets. Index components are weighted by market capitalization.
Global bonds	Barclays Capital Multiverse (Hedged) Index, which contains the government -related portion of the Multiverse Index, and accounts for approximately 14% of the larger index.
Hedge funds	HFRX Global Hedge Fund Index, which is designed to be representative of the overall composition of the hedge fund universe. It comprises all eligible hedge fund strategies; including but not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, event driven, macro, merger arbitrage and relative value arbitrage. The strategies are asset-weighted based on the distribution of assets in the hedge fund industry.
Commodities	Dow Jones-UBS Commodity Index, which is composed of futures contracts on physical commodities traded on US exchanges, with the exception of aluminum, nickel and zinc, which trade on the London Metal Exchange (LME). The major commodity sectors are represented including energy, petroleum, precious metals, industrial metals, grains, livestock, softs, agriculture and ex-energy. The Thomson Reuters / Core Commodity Index is designed to provide timely and accurate representation of a long-only, broadly diversified investment in commodities through a transparent and disciplined calculation methodology.
Cash	Three-month LIBOR, which is the interest rates that banks charge each other in the international inter-bank market for three-month loans (usually denominated in Eurodollars).
Equities	
Developed market large cap	MSCI World Large Cap Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure the equity market performance of the large cap stocks in 23 developed markets. Large cap is defined as stocks representing roughly 70% of each market's capitalization.
US	Standard & Poor's 500 Index, which is a capitalization-weighted index that includes a representative sample of 500 leading companies in leading industries of the US economy. Although the S&P 500 focuses on the large cap segment of the market, with over 80% coverage of US equities, it is also an ideal proxy for the total market.
Europe ex UK	MSCI Europe ex UK Large Cap Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure large cap stock performance in each of Europe's developed markets, except for the UK.
UK	MSCI UK Large Cap Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure large cap stock performance in the UK.
Japan	MSCI Japan Large Cap Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure large cap stock performance in Japan.
Asia Pacific ex Japan	MSCI Asia Pacific ex Japan Large Cap Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure the performance of large cap stocks in Australia, Hong Kong, New Zealand and Singapore.
Developed market small and mid-cap (SMID)	MSCI World Small Cap Index, which is a capitalization-weighted index that measures small cap stock performance in 23 developed equity markets.
Emerging market	MSCI Emerging Markets Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure equity market performance of 24 emerging markets.
Bonds	
Developed sovereign	Citi World Government Bond Index (WGBI), which consists of the major global investment grade government bond markets and is composed of sovereign debt, denominated in the domestic currency. To join the WGBI, the market must satisfy size, credit and barriers-to-entry requirements. In order to ensure that the WGBI remains an investment grade benchmark, a minimum credit quality of BBB-/Baa3 by either S&P or Moody's is imposed. The index is rebalanced monthly.
Emerging sovereign	Citi Emerging Market Sovereign Bond Index (ESBI), which includes Brady bonds and US dollar -denominated emerging market sovereign debt issued in the global, Yankee and Eurodollar markets, excluding loans. It is composed of debt in Africa, Asia, Europe and Latin America. We classify an emerging market as a sovereign with a maximum foreign debt rating of BBB+/Baa1 by S&P or Moody's. Defaulted issues are excluded.
Supranationals	Citi World Broad Investment Grade Index (WBIG)—Government Related, which is a subsector of the WBIG. The index includes fixed rate investment grade agency, supranational and regional government debt, denominated in the domestic currency. The index is rebalanced monthly.
Corporate investment grade	Citi World Broad Investment Grade Index (WBIG)—Corporate, which is a subsector of the WBIG. The index includes fixed rate global investment grade corporate debt within the finance, industrial and utility sectors, denominated in the domestic currency. The index is rebalanced monthly.
Corporate high yield	Bloomberg Barclays Global High Yield Corporate Index. Provides a broad-based measure of the global high yield fixed income markets. It is also a component of the Multiverse Index and the Global Aggregate Index.
Securitized	Citi World Broad Investment Grade Index (WBIG)—Securitized, which is a subsector of the WBIG. The index includes global investment grade collateralized debt denominated in the domestic currency, including mortgage -backed securities, covered bonds (Pfandbriefe) and asset-backed securities. The index is rebalanced monthly.

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Investment Grade			
Highest quality	Aaa	AAA	AAA
High quality (very strong)	Aa	AA	AA
Upper medium grade (Strong)	A	A	A
Medium grade	Baa	BBB	BBB
Not Investment Grade			
Lower medium grade (somewhat speculative)	Ba	BB	BB
Low grade (speculative)	B	B	B
Poor quality (may default)	Caa	CCC	CCC
Most speculative	Ca	CC	CC
No interest being paid or bankruptcy petition filed	C	D	C
In default	C	D	D

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