Discovery Global Real Estate Securities Feeder Fund

Q4 2024 Commentary

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The final quarter of 2024 ended with the Fund underperforming by 206 bps as the benchmark decreased by 9.69% and the Fund decreased by 11.75%. The underperformance was driven mainly by the first and second bites of the apple—region and sector allocation—which hit performance by 156 bps, and the third bite of the apple, stock selection, which hit performance by 62 bps. We held a 4% cash position during the quarter, which contributed a marginal positive impact on performance of 12 bps. The fourth quarter was challenging for real estate stocks as the rate cuts that were priced in for 2024 and 2025 were reduced, making forecasts less favourable and debt more expensive. We had anticipated this for the US and were, therefore, underweight in that geography. However, US stocks performed better than the other regions, with rate expectations rising even faster elsewhere. Our most overweight region, the UK, turned out to be the weakest performer of all.

Regional performance for the quarter was weak, with all regions performing negatively. The US was the strongest market, down only 7%, but we were underweight, given unattractive valuations and interest rate risk. Hong Kong developers moved in line with the index as they were down almost 10%, while Hong Kong REITs were down 13%. We are overweight Hong Kong, given attractive valuations and stabilising fundamentals. In Japan, developers were down 10%, and REITs were down 12%. We remain underweight, given the demographic challenges and likely interest rate rises. At the opposite end of the spectrum, the weakest region for the quarter was the UK, down 21%, with the Bank of England holding rates constant at the end of the quarter. We prefer the UK as cap rates are high and balance sheets are strong. Europe and Australia were both down 17%, and we are underweight in both markets—the EU because of weak economics and Australia because valuations are full, and inflation persists.

The best-performing US sector was data centres, which grew by 6%, as artificial intelligence demand and cloud storage continue to boost demand, and we remain slightly overweight in the sector. The second-best performer was malls, up 3%, but we are underweight as valuations are rich. The third best sector was lodging, which was flat for the quarter, where we have no exposure given historic underperformance during economic slow-downs. The weakest performing sector was storage, down 18%, where we are underweight, given demand has weakened consistently through the year. The second weakest performer was industrial, down 17%, where we were marginally underweight as the sector has seen weak demand, and we expect guidance to be more conservative for 2025. The third weakest sector was net leases, down 16%, where we were marginally overweight. Rates have not moved as favourably for this sector as we had hoped, and external growth has also been delayed. Our most overweight sector is offices, as assets have already been aggressively written down, and fundamentals are improving at the margin. We are also overweight shopping centres as valuations are attractive relative to malls, and recent deals have been accretive. Our biggest underweight is healthcare, where senior housing stocks have rallied throughout the year, stretching valuations beyond the fundamentals.

The top-performing stocks this quarter were all from the US. US data centre stocks performed well, with Digital Realty rising 10% and Equinix gaining 6%, securing first and third place, respectively. In second place was Macerich, the mall stock, up 9%. The worst-performing stocks were all from the UK/Europe. Big Yellow, the UK storage stock, was down 30%, but we exited it in the middle of the quarter as storage demand weakened. The second weakest stock was Warehouse De Pauw, the EU logistics stock, down 26%, which we only acquired late in the quarter after value emerged for its high-quality portfolio. The third weakest performer was Segro, the UK logistics stock, down 25%, where we maintain our position as we believe that the stock has been oversold on macro concerns, while the nuts-and-bolts of their logistics portfolio remain solid.

In 2024, property stocks significantly underperformed the broader market, resulting in a significant relative valuation discount. Historically, such discounts have often paved the way for the sector to outperform in the following year. However, absolute property stock valuations are fair, and we anticipate a single-digit absolute upside in 2025, with some headwinds from stubbornly high interest rates and slowing economic growth. Asia presents a potential bright spot, with stocks offering attractive valuations and already bearish assumptions. We wish you all the best for 2025.