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U.S. Real Estate Gaining Traction with Investors

Quality Strategies Offer Potential for Investment Gains, Income & Diversification in Volatile Times for Bonds & Equities

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With U.S. Treasury bond yields at near-historic lows, and domestic equity volatility on the rise, investors are hard-pressed to find "safe havens." No investment with any risk can ever be guaranteed, but certain options can carry less risk while potentially producing much-needed income along with the possibility of capital appreciation and enhanced portfolio diversification.

Legg Mason affiliate Clarion Partners, LLC, based in New York, highlights the principal reasons supporting investment in this burgeoning sector, including:

- Attractive absolute and risk-adjusted historical total returns.
- A history of high current income, with the potential to hedge inflation and rising interest rates.
- Anticipated diversification benefits within a mixed-asset portfolio.
- Increased market depth and liquidity due to the ongoing influx of institutional capital.
- Favorable supply and demand fundamentals for the asset class.
- Good value relative to other asset classes.

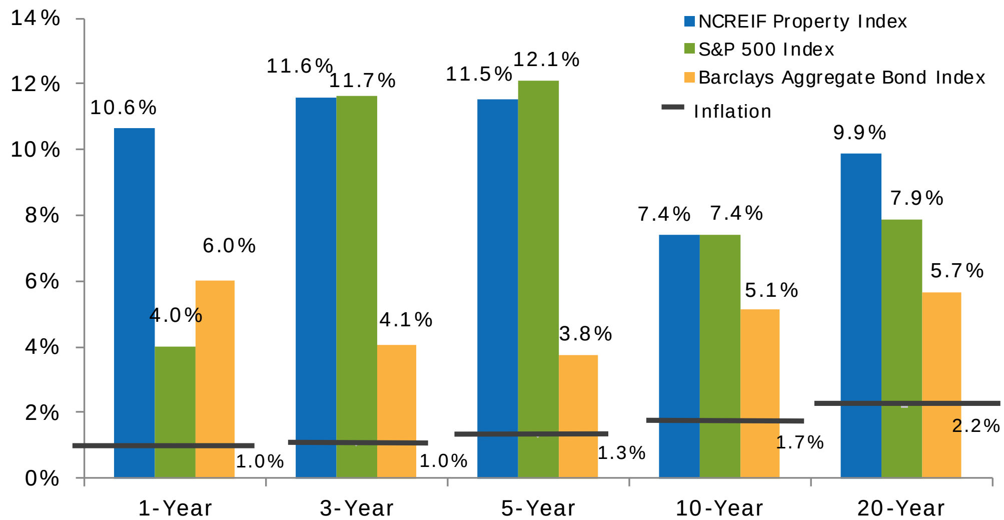
"Core real estate returns generated over market cycles including the one we are now in, have consistently remained within 7 to 10 percent[1]," explained David Gilbert, President and Chief Investment Officer of Clarion Partners. "This is particularly impressive, considering this most recent cycle encompasses the 2008- 2009 Global Financial Crisis. While core real estate pricing is above its 2007 peak, this is not a cause for alarm. The economy, labor market and population – factors that ultimately drive real estate demand – also are past their pre-recession peaks."

"Fundamentals and capital markets point to continuing expansion of the U.S. real estate cycle," Mr. Gilbert predicted. "Even now, in the seventh year of this current cycle, we believe that relative valuation metrics and favorable supply/demand fundamentals suggest that core real estate is positioned for an extended run, even if an economic downturn happens sooner than anticipated."

Market analysis shows that historical returns are compelling, and core real estate pricing continues to offer strong performance relative to other tradeable asset classes: over the past 20 years, total returns for real estate have at times significantly outperformed most stocks and bonds.

“Real core real estate pricing – adjusted for inflation – recovered to its pre-recession peak as of the first half of 2016. On a relative basis, it still trails public equity market valuation and real GDP,” Mr. Gilbert added. It could also bode well for investors who seek enhanced returns and income through core real estate.

EXHIBIT 1: Core Real Estate Returns Compared to Other Asset Classes, Inflation



Source: Barclays Capital, National Council of Real Estate Investment Fiduciaries (NCREIF), Standard and Poor’s (S&P), Clarion Partners Investment Research, as of 6/30/16. Past performance is not a guarantee of future results, and a risk of loss exists.

“The ‘slow-but-steady’ labor market and economic expansion will likely keep upward pressure on rents and occupancies, since supply growth generally lags demand,” Mr. Gilbert said. “A core real estate strategy seeks to invest in quality commercial buildings using low leverage. Well-leased apartment, industrial, office, and retail properties comprise the majority of a core real estate portfolio. Effective property management can drive net operating income growth during economic expansions and can stabilize asset cash flows in market downturns.”

With prospects of Federal Reserve rate hikes mounting, the potential for growth in current income of real estate also may also provide a hedge against inflation and mitigate impacts of a rising interest rate environment.

As Mr. Gilbert explained, “U.S. core real estate has demonstrated that even modest macro growth trends can translate into robust gains in property-level net operating income.”

Adding core real estate to a mixed-asset portfolio also can offer diversification benefits.

“The inclusion of core real estate within a mixed-asset portfolio can help reduce overall portfolio volatility through asset diversification,” Mr. Gilbert said. “Historical returns can have very low or negative correlations with most stock and bond indices. Additionally, large core funds offer the potential for intra-class diversification through exposure to different property types, regions and metro areas, and industries.”

Core real estate allocations held for at least six years can mitigate vintage year risk, he noted.

[1] NCREIF Property Index for the 1, 3, 5, 10 and 20 year periods as of 6/30/2016

"Looking back 30 years (over rolling 6 year returns) the NCREIF Property Index has generated solid performance," Mr. Gilbert said. "Cyclical peaks are difficult to forecast, but the historical consistency of income returns can make core real estate an attractive investment vehicle for disciplined investors facing an uncertain global outlook. Institutional investors have increased allocations to core real estate steadily over the past two decades."

About David Gilbert

The President and Chief Investment Officer of Clarion Partners, David Gilbert is a member of the firm's Executive Board and Operating Committee, as well as Chairman of the Investment Committee. Mr. Gilbert is also responsible for oversight of the Investment Research Group. He joined the firm in 2007 and began working in the real estate industry in 1983. Mr. Gilbert is on the Board of Directors of the Pension Real Estate Association and a member of the Urban Land Institute. He also serves on the Board of Directors of Spirit Realty Capital, a $7 billion public REIT focused on net lease investing. He earned an M.B.A. in 1987 from The Wharton School of the University of Pennsylvania, and a B.B.A. in 1979 from the University of Massachusetts.

About Clarion Partners, LLC

Legg Mason affiliate Clarion Partners, an SEC registered investment adviser, FCA authorized manager and FINRA member firm, has been a leading U.S. real estate investment manager for more than 34 years. Headquartered in New York, the firm has offices in Atlanta, Boston, Dallas, London, Los Angeles, São Paulo, Seattle and Washington, DC. With more than $42 billion in assets under management, Clarion Partners offers a broad range of real estate strategies across the risk/return spectrum to more than 200 domestic and international institutional investors. www.clarionpartners.com.

NCREIF Property Index is a quarterly, unleveraged composite total return for private commercial real estate properties held for investment purposes only. All properties in the NPI have been acquired, at least in part, on behalf of tax-exempt institutional investors and held in a fiduciary environment.

The **Standard & Poor's 500 Index** (S&P 500) is an index of 500 stocks seen as a leading indicator of U.S. equities and a reflection of the performance of the large cap universe, made up of companies selected by economists.

Barclays Aggregate Bond Index is an unmanaged index of U.S. investment- grade fixed-income securities. Please note an investor cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

All investments involve risk, including loss of principal. Past performance is no guarantee of future results. Investment in the real estate market entails significant risks and is suitable only for certain investors as part of an overall diversified investment strategy and only for investors able to withstand a total loss of investment. Equity securities are subject to price fluctuation and possible loss of principal. Dividends may fluctuate and a company may reduce or eliminate its dividend at any time. Diversification does not guarantee a profit or protect against a loss. Fixed-income securities involve interest rate, credit, inflation, and reinvestment risks; and possible loss of principal. As interest rates rise, the value of fixed-income securities falls. Diversification does not guarantee a profit or protect against a loss. U.S. Treasuries are direct debt obligations issued and backed by the full faith and credit of the U.S. government. The U.S. government guarantees the principal and interest payments on U.S. Treasuries when the securities are held to maturity.

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