Merchant West SCI Global Property Income Fund
Quarterly Report
Quarter ending 31 March 2023

Fund Details

Benchmark	ASISA Category	Portfolio Managers	Suitable Investor
GPR 250 REIT Index Total Return (TR) in rand	Global Real Estate General	Richard Henwood Ian Anderson	The Merchant West Sanlam Collective Investments Global Property Income Fund is suitable for investors seeking a specialist global property portfolio with the objective of providing investors with high income and long-term capital appreciation.

Top 10 Holdings

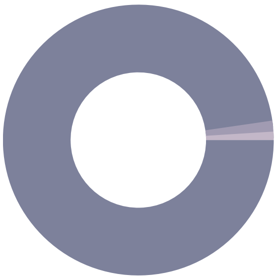
Top 10 Holdings	%
Prologis Inc	8,4
Public Storage Inc	4,6
CubeSmart	3,9
American Tower Corporation	3,8
Simon Property Group Inc	3,5
Invitation Homes Inc	3,2
Welltower Inc	3,1
AvalonBay Communities REIT	2,8
Mid-America Apartment Communities	2,8
Federal Realty Investment Trust	2,7

Highest and Lowest Annual Returns

Highest and Lowest Annual Returns	%
Highest Annual %	50,0
Lowest Annual %	-25,3

Asset Allocation

Portfolio date: 31/03/2023



Asset Allocation	%
Global Property	97,7
Global Cash	1,3
SA Cash	1,0
Total	**100**

Annualised Performance

Annualised Performance	Fund %	Benchmark %
3 months	2,2	5,9
1 year	-13,6	-2,8
3 years	4,7	10,2
5 years	4,7	12,5
10 years	5,6	11,4
Since Inception (April 2009)	11,5	15,7
Launched date (April 2009)		

Market Overview

The collapse of Silicon Valley Bank (SVB) in the United States and Credit Suisse in Switzerland during the first quarter of 2023 highlights some of the issues regulators are facing in trying to contain inflation by aggressively raising interest rates. While both banks are not representative of the global banking sector generally, the repricing of bank assets held in government bonds is a risk to the sector as a whole and is a function of higher inflation and higher interest rates. Regulators were quick to act in both cases, with the US Federal Reserve guaranteeing all deposits at SVB, while the Swiss regulators quickly engineered a takeover of Credit Suisse by its largest competitor, UBS. While the crisis was short-lived, it did have a material impact on the share prices of most banks in the United States and Europe and is also likely to place a dampener on economic growth as banks reassess the quality of their asset books and adopt more stringent lending criteria. On the other hand, central banks are likely to be more circumspect about the pace and magnitude of further interest rate hikes given the fragility of certain banks in the financial system.

During the first quarter, global bond yields fell on expectations that central banks (and the US Fed in particular) will reduce the magnitude of rate hikes at upcoming policy meetings and start cutting interest rates again before the end of the year. The US Fed did raise official interest rates by 25 basis points at both the February and March meetings of the Federal Open Market Committee, but these were lower than the 50 basis point increase in December 2022 and the 75 basis point increases in June, July, September and November last year. The yield on 10-year US Treasuries fell more than 40 basis points during the quarter to trade below 3.5%, having touched 4.25% towards the end of last year. Lower bond yields helped growth stocks stage a significant rally in the first quarter, with the tech-heavy NASDAQ Index gaining 17%, while the Dow Jones Industrial Average (DJIA) was up just 0.9%. The NASDAQ underperformed both the DJIA and S&P 500 last year as bond yields in the United States rose by around 250 basis points.

While global real estate markets continue to be negatively impacted by the sharp spike in global bond yields, improving fundamentals across several property types and strong results from most companies in the sector helped push global real estate securities higher in the first quarter. Market participants are, however, concerned about the refinancing risks facing many office landlords, as debt currently attracting very low interest rates is maturing over the next 18 months at a time when interest rates are rising, and office fundamentals are still weak. There has been an improvement in trading densities in shopping malls, but fundamentals are not strong enough for a sustained increase in market rentals. Demand for warehousing remains strong as more companies look to stockpile inventories and raw materials to insulate themselves from any further disruptions to global supply chains, although there is likely to be some fallout from Amazon's decision to start shutting older warehouses in favour of newer, larger and more technologically advanced buildings.

Market Review and Portfolio Action

During the quarter, the Fund produced a positive return of 2.22% (in ZAR), underperforming its benchmark (GPR250 REIT Index in ZAR +5.88%) and its peer group average (+4.16%). The Fund benefitted from positive returns from its self-storage (+17%), logistics (+13%) and residential (+6%) property exposure. The Fund's best individual performers (in ZAR) during the quarter were Life Storage (+40%), Cubesmart (+21%), Prologis (+16%) and Equinix (+15%). The positive returns were however offset by negative returns from the Fund's office (-12%) property exposure. The worst individual performers (in ZAR) were Hudson Pacific (-26%), SL Green (-25%), Orion Office (-17%) and Vonovia (-16%).

Life Storage's strong performance during the quarter came about after the company received a hostile bid from Public Storage in early February. The company rejected the all-stock offer which equated to around $124 per share. The company was trading at around $110 at the time of the announcement. There was speculation that Public Storage could increase its offer to around $140 per share, or an alternative bidder may enter the fray, which pushed the Life Storage share price higher into quarter-end. In the first week of April, Life Storage's Board announced that they had struck a $12.7bn deal to combine with Extra Space Storage Inc in an all-stock deal. The offer equated to around $146 per share for Life Storage shareholders, which is a premium of 33% above where the Life Storage's share price was before the initial offer from Public Storage was announced in early February. If approved by shareholders, the transaction is expected to close in the second half of 2023. The corporate activity in the self-storage sector also had a positive impact on the Cubesmart share price during the first quarter.

US Office REITs had a poor first quarter of 2023 after the recent failure of several regional US banks and Credit Suisse triggered concerns about the potential impact on commercial real estate markets. It's thought US banks hold around half of the commercial real estate mortgage debt in the United States, with the smaller regional banks having the highest exposure. After a period of historically low interest rates, investors are becoming more wary as to which landlords or property sectors may be more negatively impacted by higher interest rate risks when it comes time to refinance maturing debt. US office landlords appear to be the most at risk, as vacancies continue to move higher due to lower demand from tenants with a high percentage of staff still working from home, and a slowing US economy leading to increased retrenchments at large corporates. More than half of the 25 worst-performing US REIT stocks in the first quarter of 2023 came from the US office sector, with Hudson Pacific Properties and SL Green the worst performers.

Current Positioning and Outlook

The Fund continues to maintain full exposure to global listed property. The Fund is well diversified across geographical regions but does have significant exposure to North America (79%) and less exposure to the UK (9%), Europe (6%) and Asia (4%). Compared to its benchmark, the Fund is overweight developed markets (US, UK, and EU) and underweight Asia. The Fund is well diversified across various property types but holds significant exposure to the residential (21%), retail (21%) and logistics warehouse (14%) property sectors. The Fund also has exposure to alternative property types, such as self-storage (10%), healthcare (7%) and technology (11%) – being data centres and mobile towers – which provides diversification away from the traditional commercial property types (e.g. office).

In 2021, global REITs produced their best calendar year performance since 2006, delivering a total return of +35.3% in USD (as per GPR250 REIT Index). The asset class benefitted from the roll-out of COVID-19 vaccines across many developed markets in early 2021, resulting in many in-person activities being able to resume, including shopping, education, domestic leisure travel and healthcare procedures. The combination of pent-up demand, substantial fiscal stimulus from central banks and disruptions in the global supply chain caused a significant mismatch in supply and demand across many industries in 2021.

This has contributed to a surge in inflation across many developed markets. The higher-than-expected inflation in 2022 has however created concerns around the global macro-environment, and a specific focus on the interest-rate policies of central banks as they look to combat inflation in 2022 and 2023.

After initially making no change at their January meeting in 2022, the US Federal Reserve increased their target Fed Funds rate by 4.25% between March and December. The significant increase in interest rates from the Fed, as well as their counterparts in the UK and Europe, affected global bond and equity markets negatively in 2022 as investors adjusted to the end of "cheap money" provided by loose monetary policies since the 2008 Global Financial Crisis (GFC). Listed real estate was one of the worst-performing asset classes, with global REITs underperforming the broader equity markets in 2022. The GPR 250 REIT Index declined by 24.0% in USD and 18.8% in ZAR during 2022.

The US Federal Reserve has increased interest rates in the US by another 50 basis points in the first quarter of 2023, leaving its current target range between 4.75% and 5.00%. Fed Futures are currently pricing in another 0.25% interest hike in May. But there is a growing expectation that the Fed may cut interest rates in the second half of 2023 to assist the US (and global) economy in avoiding a protracted recession. Global REIT earnings expectations for 2023 have decreased slightly over the last six months due to higher interest rate costs. The significant price decline seen in global REITs during 2022 resulted in a compression of valuation multiples, as long-dated bond yields moved significantly higher. We have however already seen those yields decline in 2023, leading to a slightly positive start for global REIT prices in Q1 2023.

The Fund continues to favour investments in high-quality Real Estate Investment Trusts (REITs) that are expected to withstand the impact of technological disruptions. The Fund is well diversified both geographically and by property type. The Fund continues to offer investors a level of initial income higher than global bonds, as well as inflation-beating income and capital growth over the medium and long term. The current one-year forward yield on the portfolio is 4.3% (before fees and dividend withholding taxes) and the portfolio's income is expected to grow by 7% per annum over the next three years. The Fund distributes on a semi-annual basis (June and December).

Richard Henwood
Portfolio Manager