HEALTH WEALTH CAREER

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MARKET ENVIRONMENT

April 21, 2016

Anthony Brown
US Director of Strategic Research

Paul Kolevsohn
Head of North American Real Estate

AGENDA
WHAT WE WILL COVER TODAY

- Performance recap
- Macro environment
- Outlook for equities and credit
- Real estate update
- Questions

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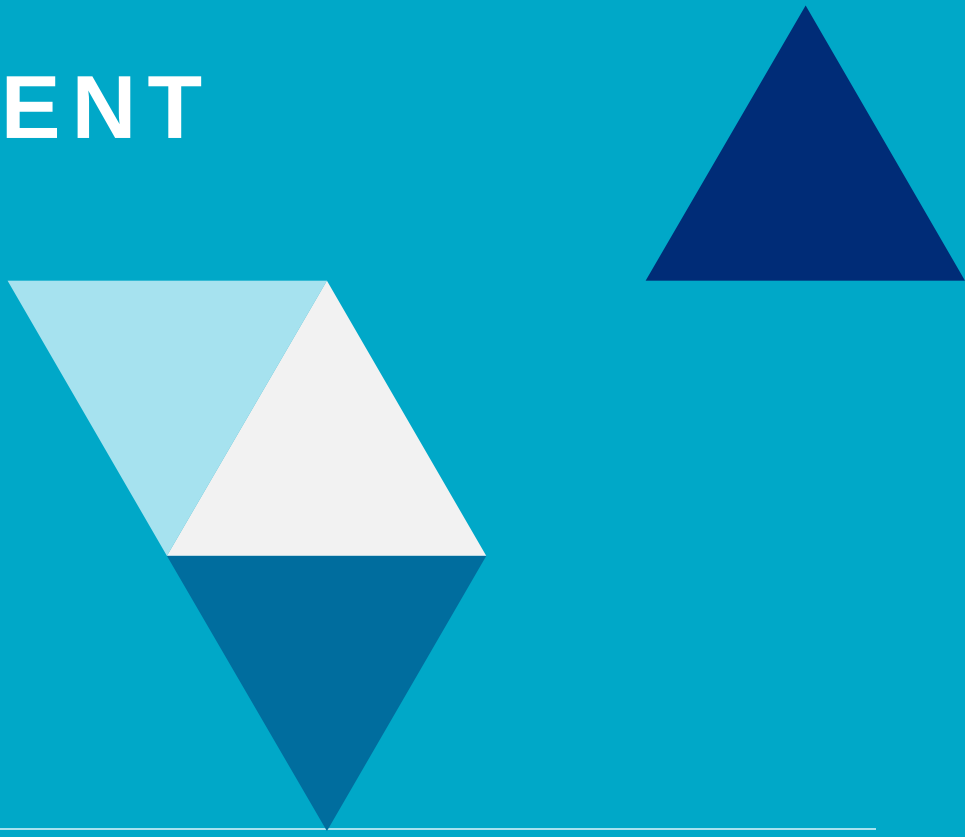
MARKET ENVIRONMENT



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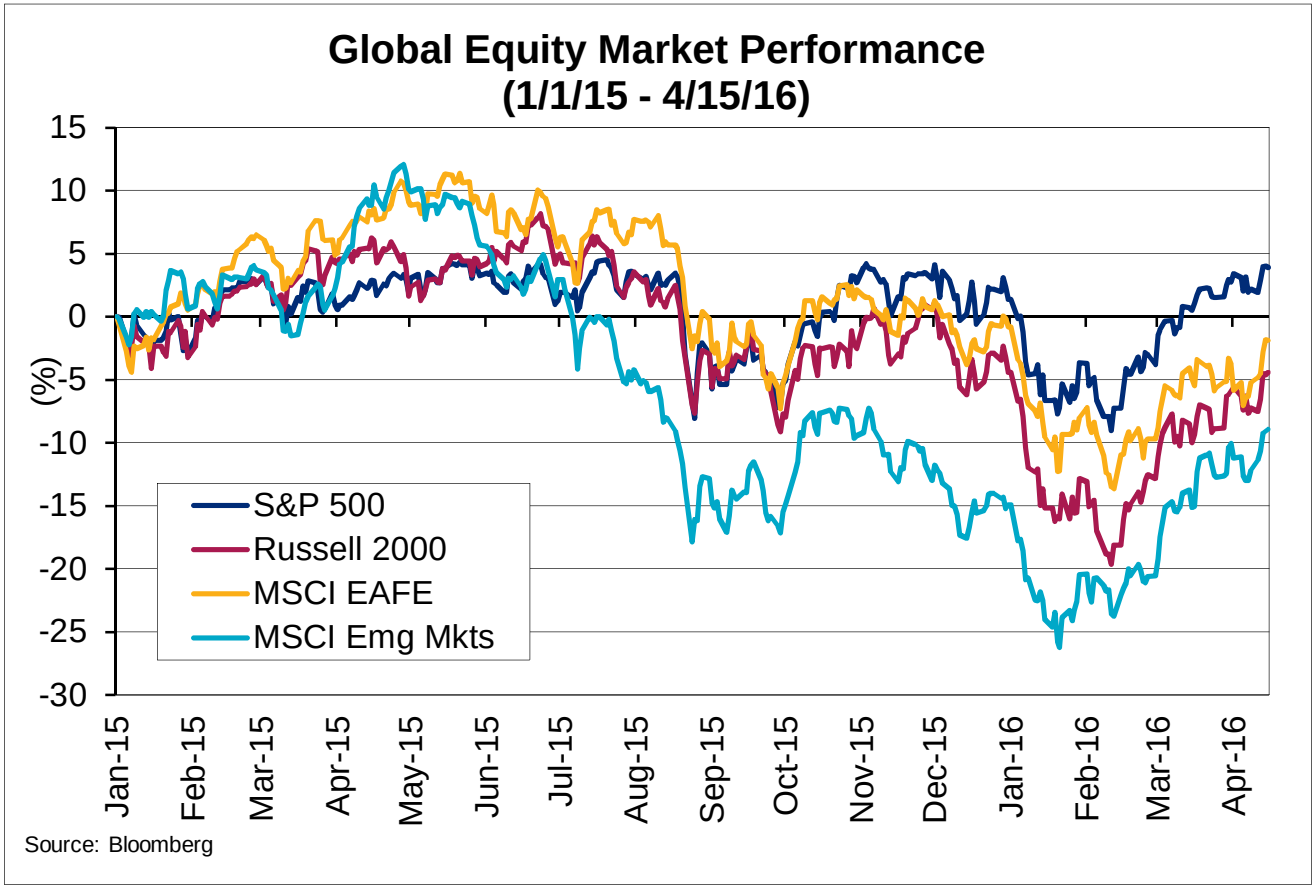
A VOLATILE START TO 2016



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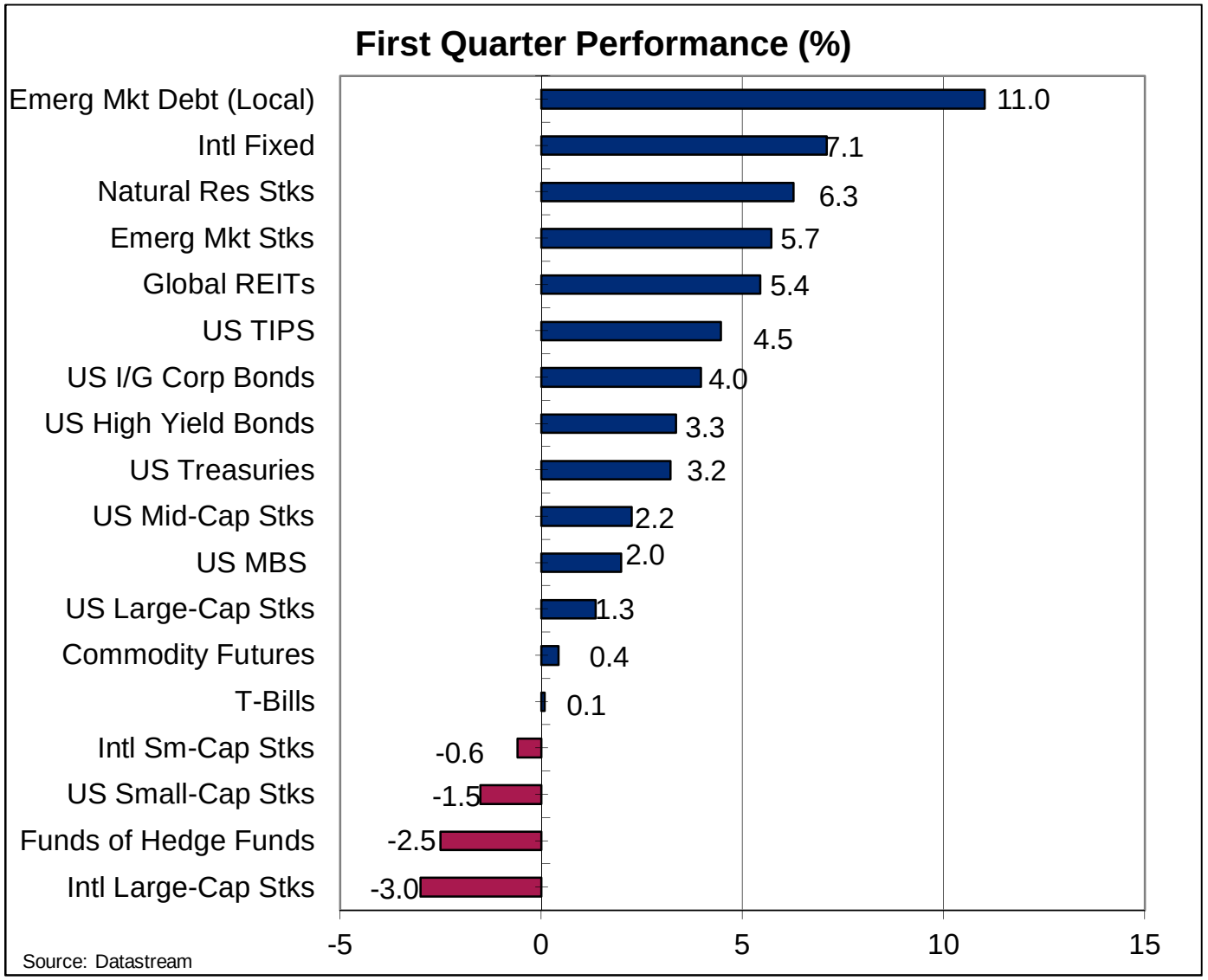
FIRST QUARTER PERFORMANCE NOT SO BAD



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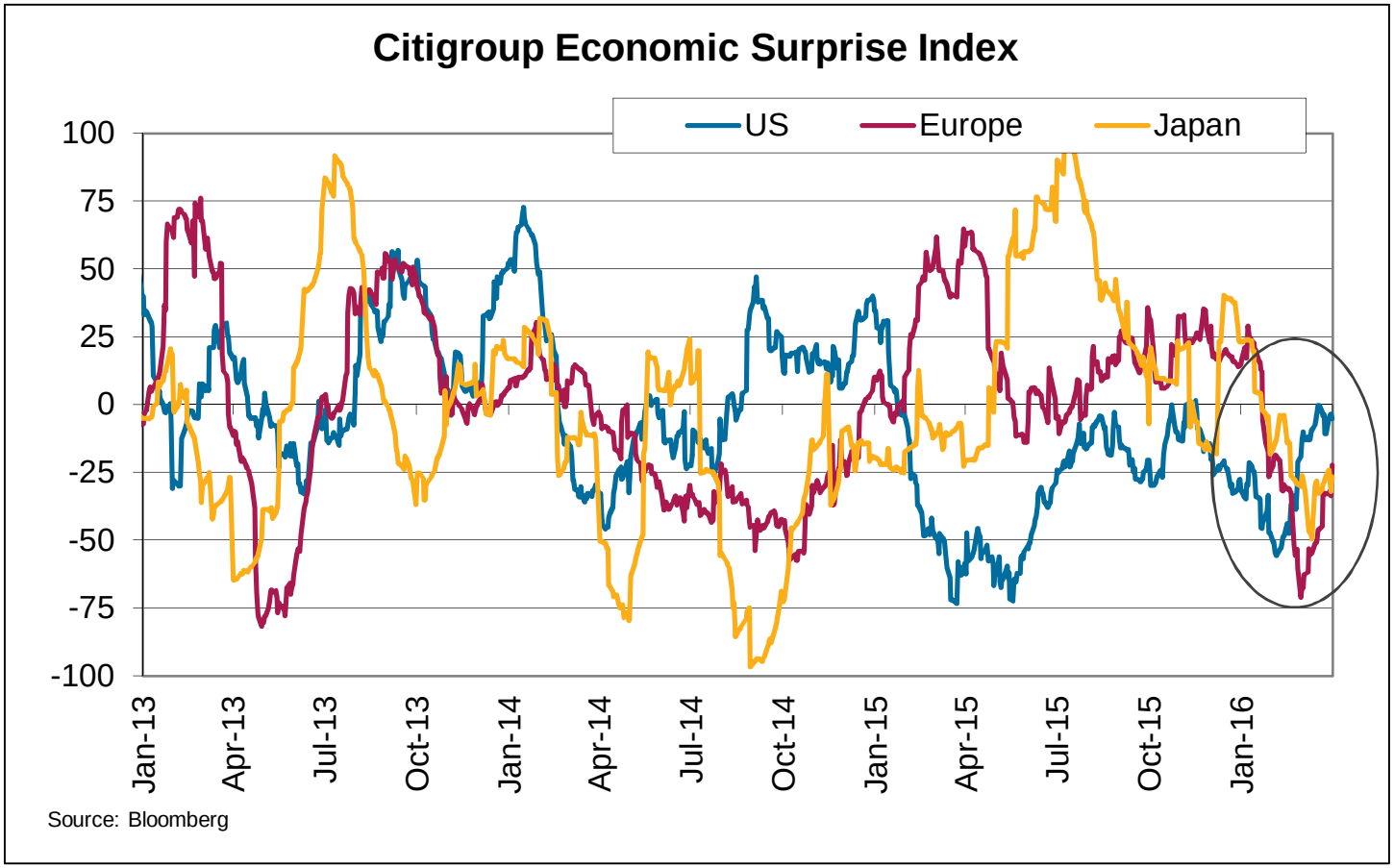
GLOBAL RECESSION FEARS HAVE FADED



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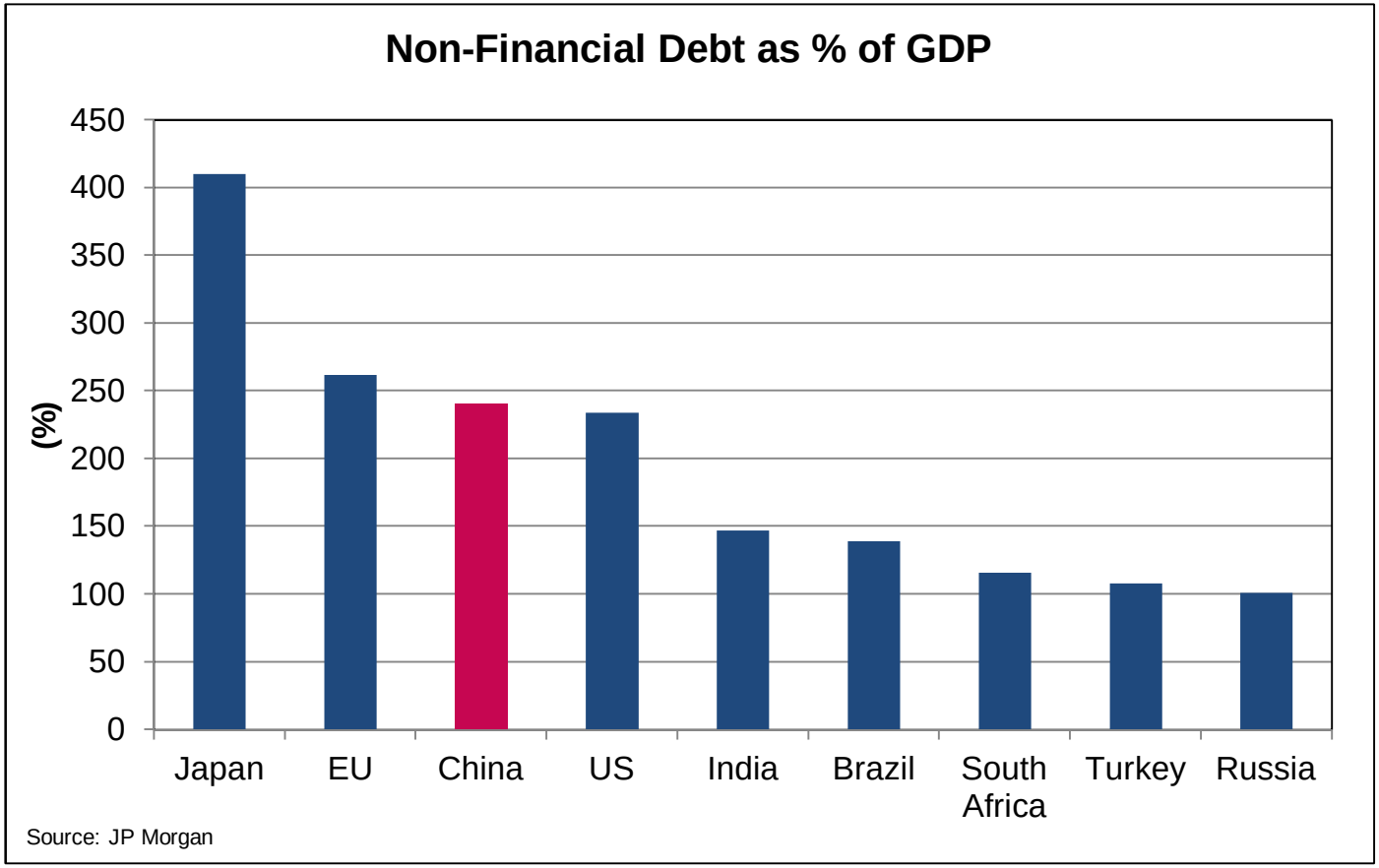
CHINESE STIMULUS EASED CONCERNS



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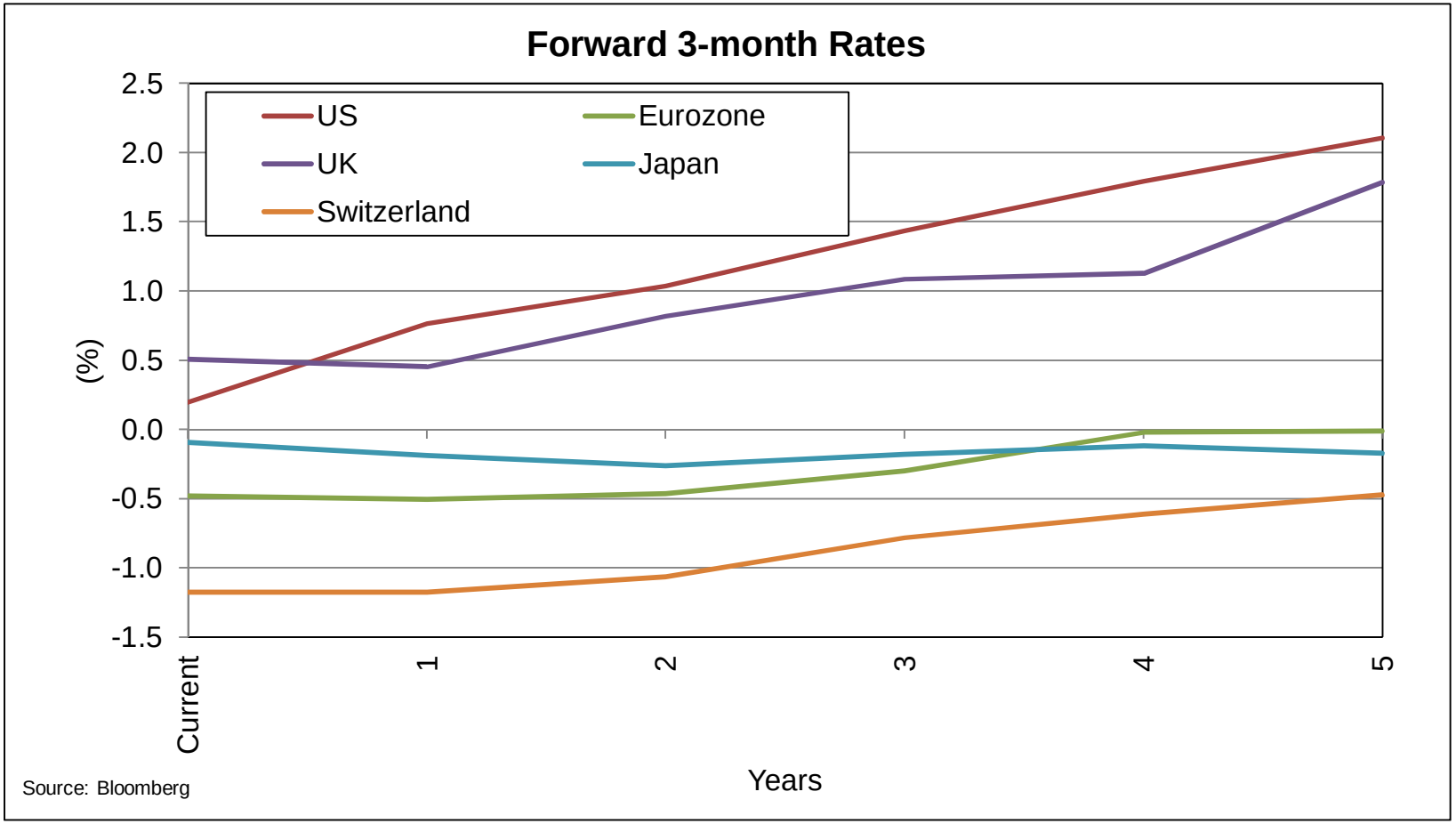
ECB AND BOJ EXPANDED STIMULUS, WHILE THE FED LOWERED EXPECTATIONS



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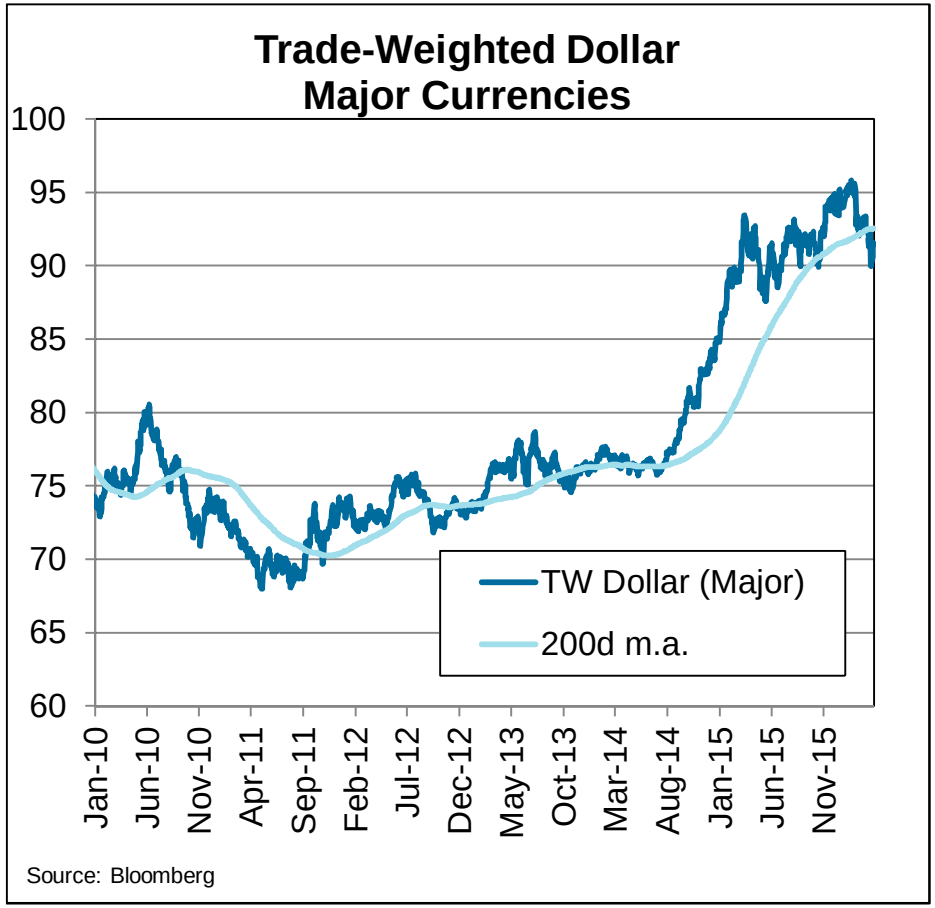
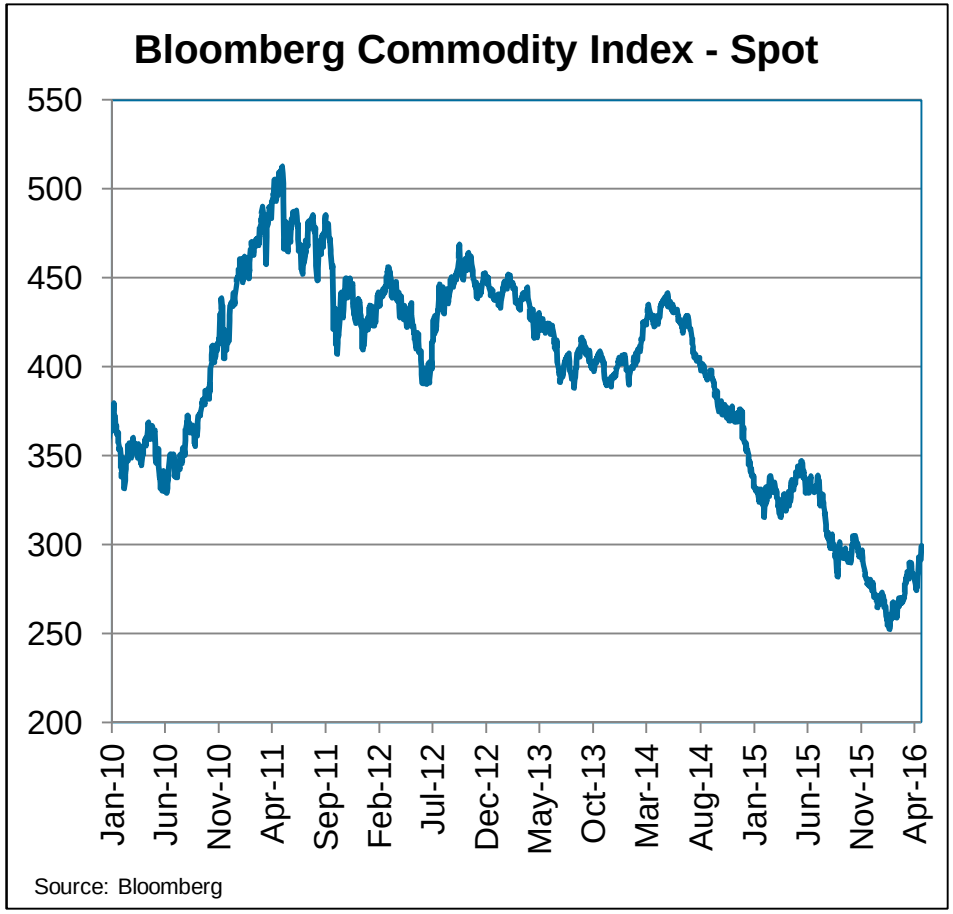
WEAKER DOLLAR AND REBOUND IN COMMODITIES EASED PRESSURES ON EMERGING MARKETS





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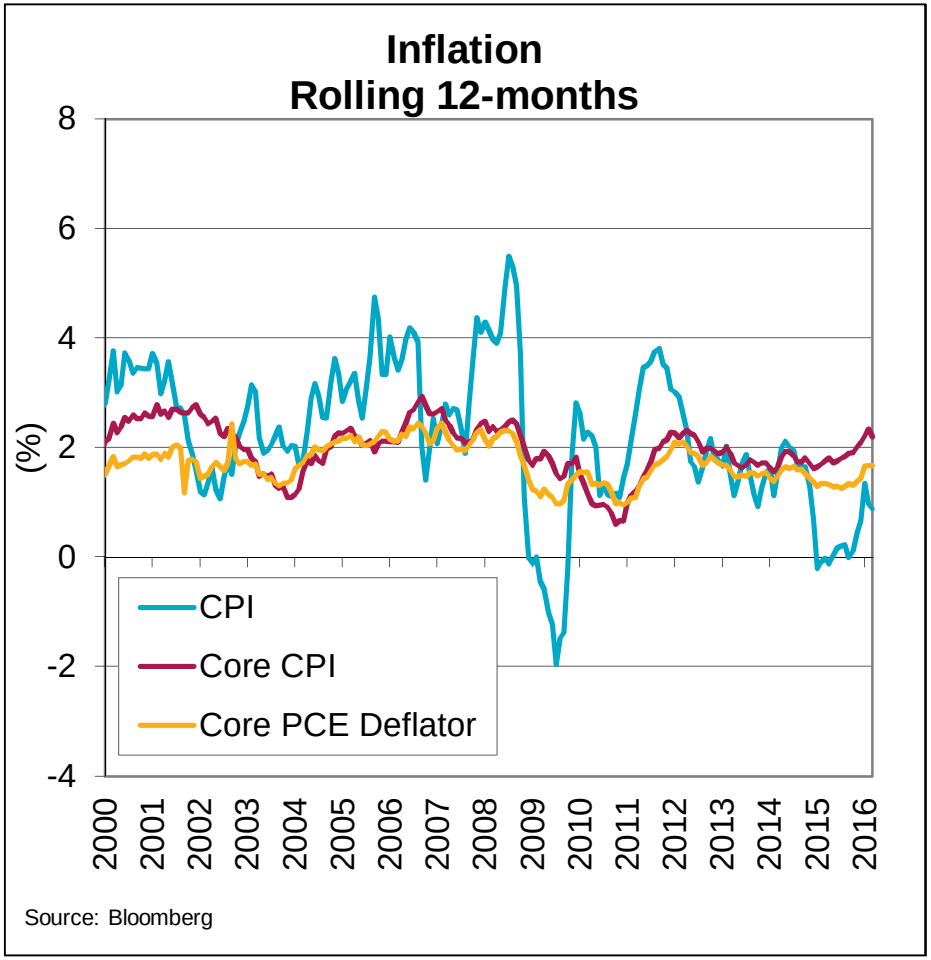
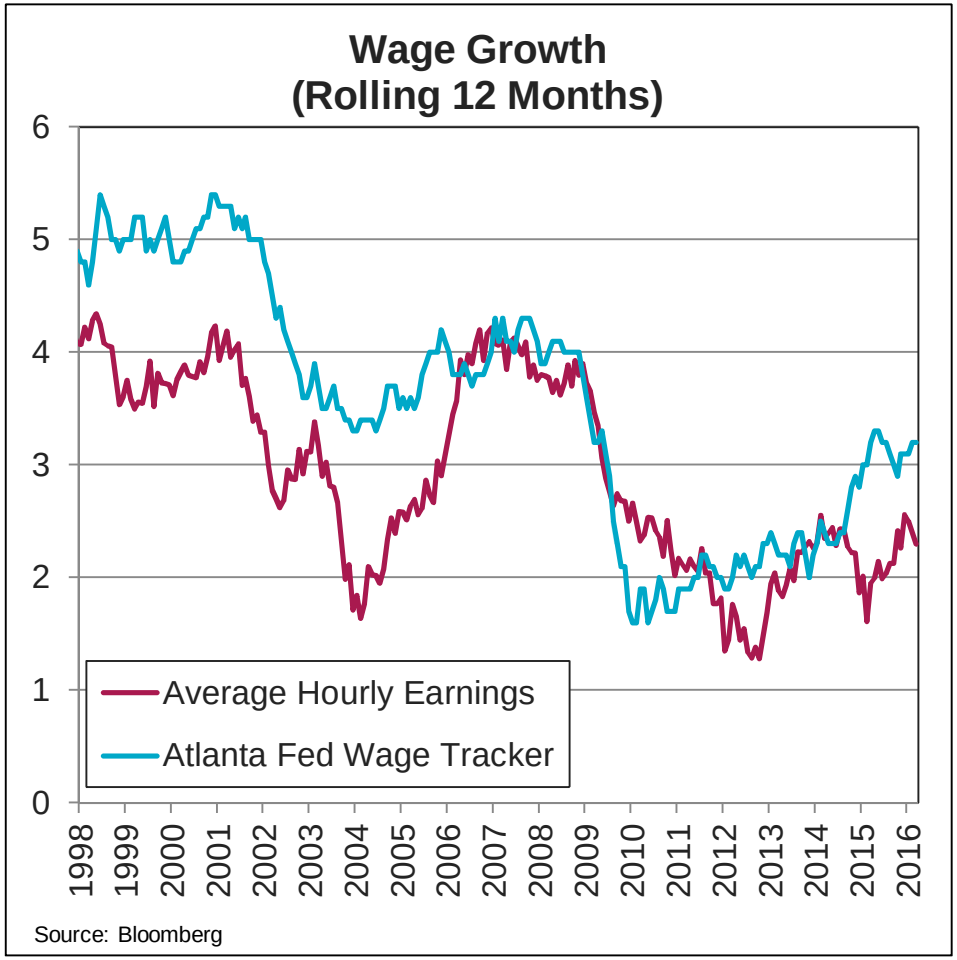
COULD THE FED TURN MORE HAWKISH LATER IN 2016?





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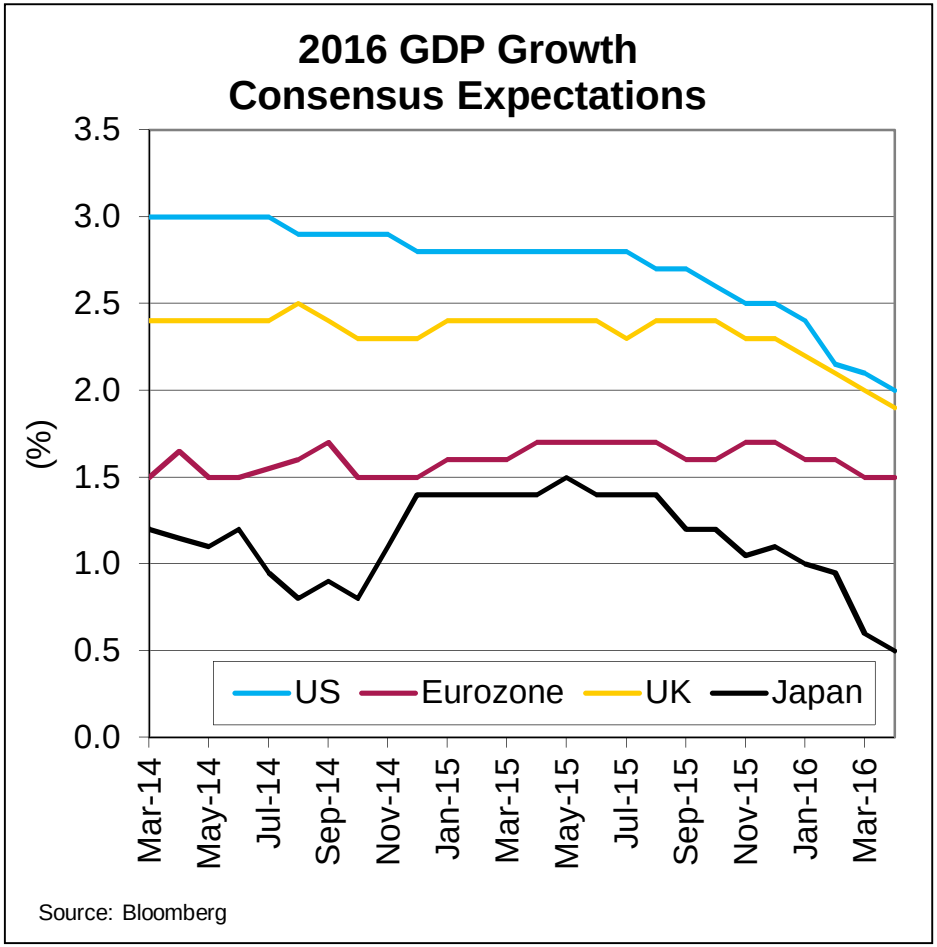
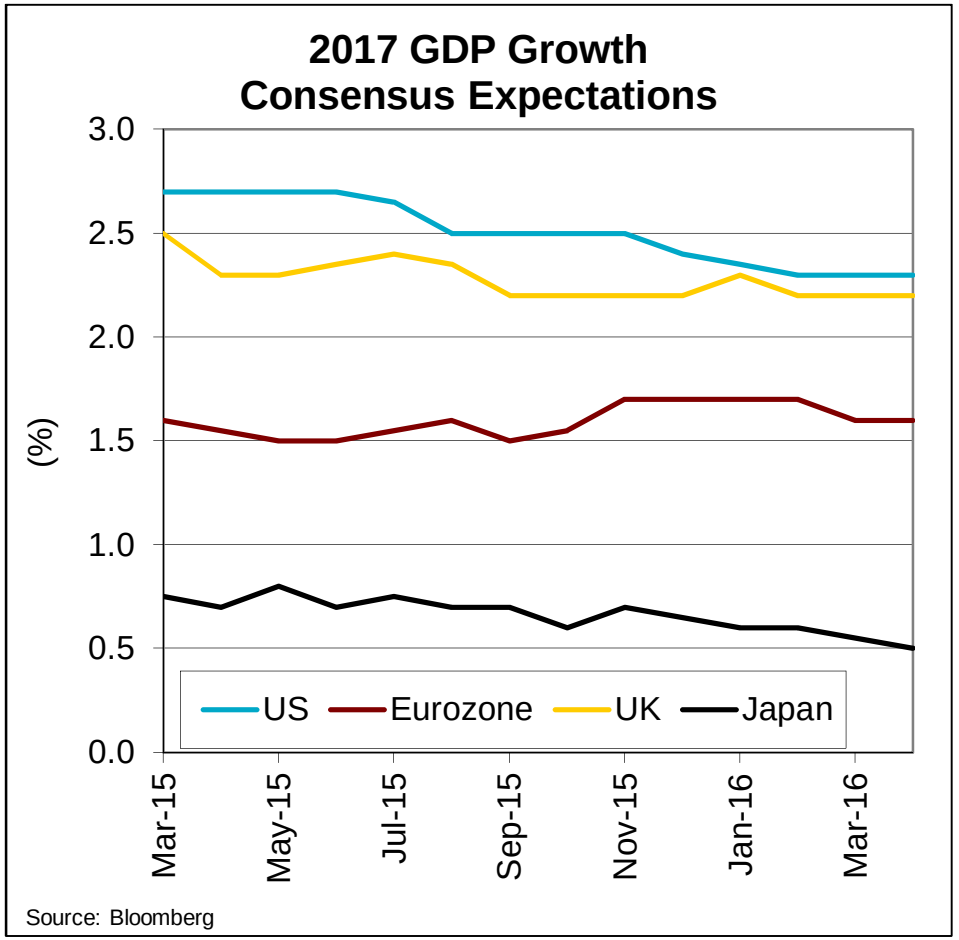
ECONOMISTS TRIMMING GROWTH EXPECTATIONS





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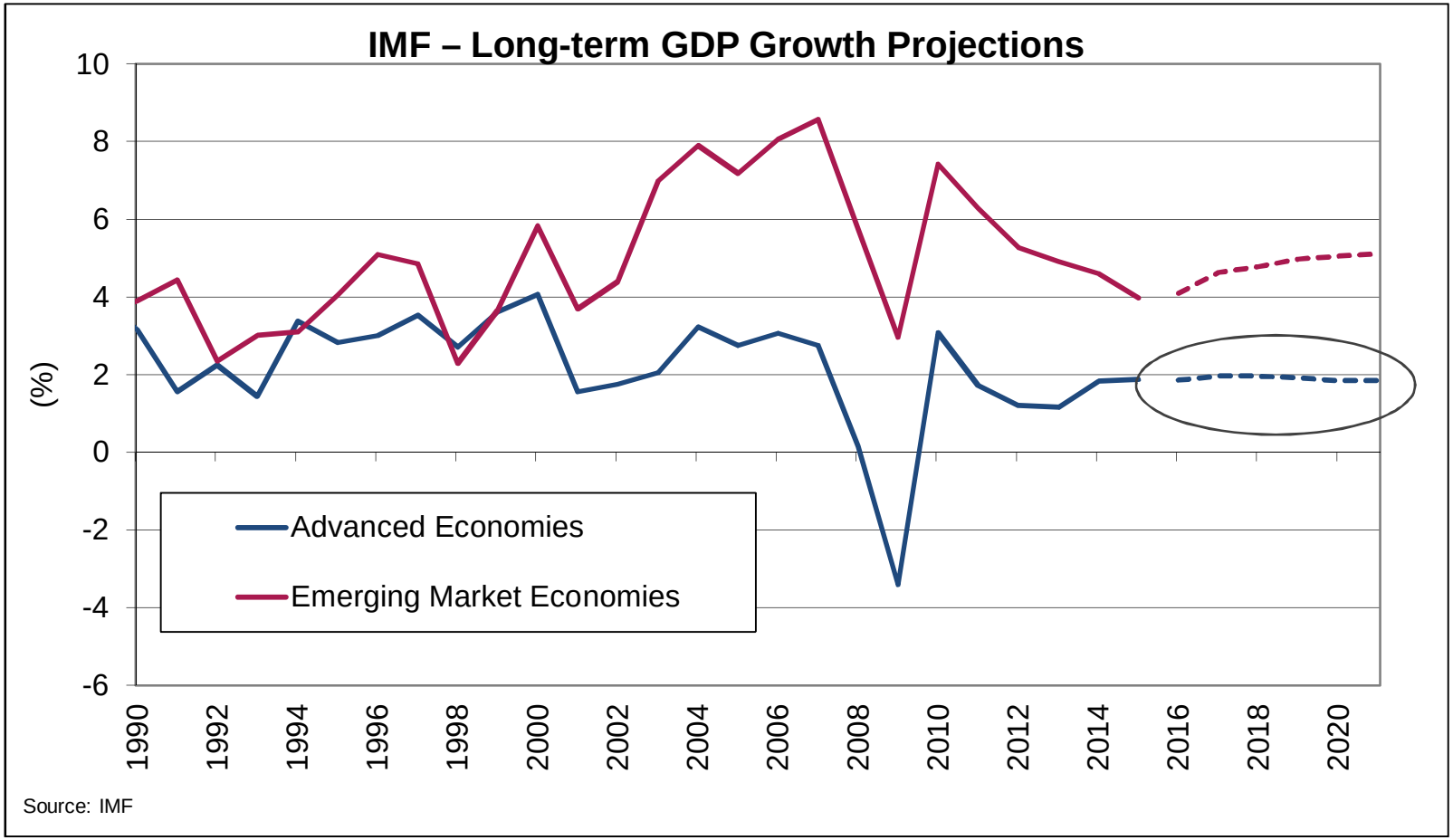
IS THIS AS GOOD AS IT GETS?



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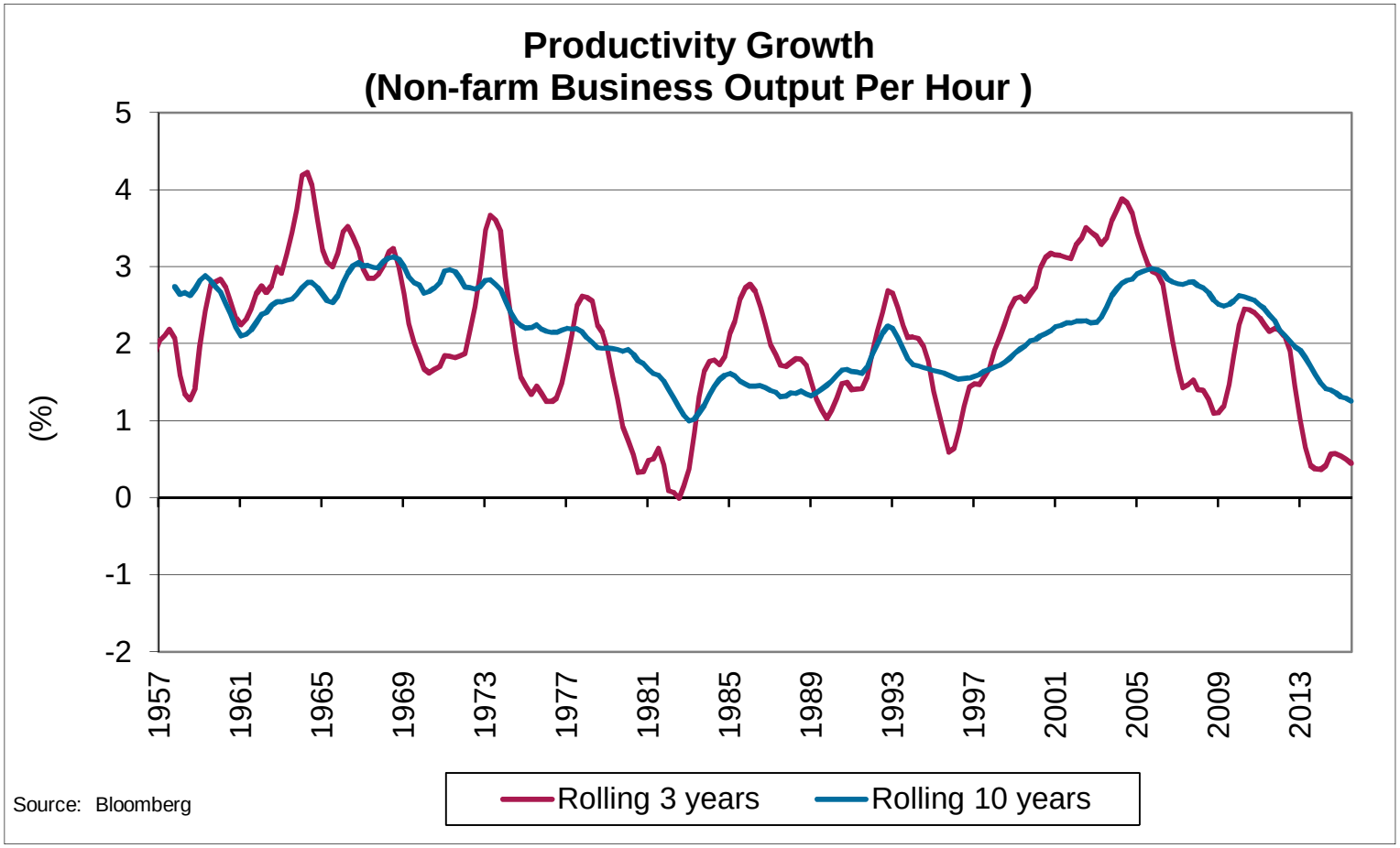
US: CONCERNING TREND IN PRODUCTIVITY GROWTH



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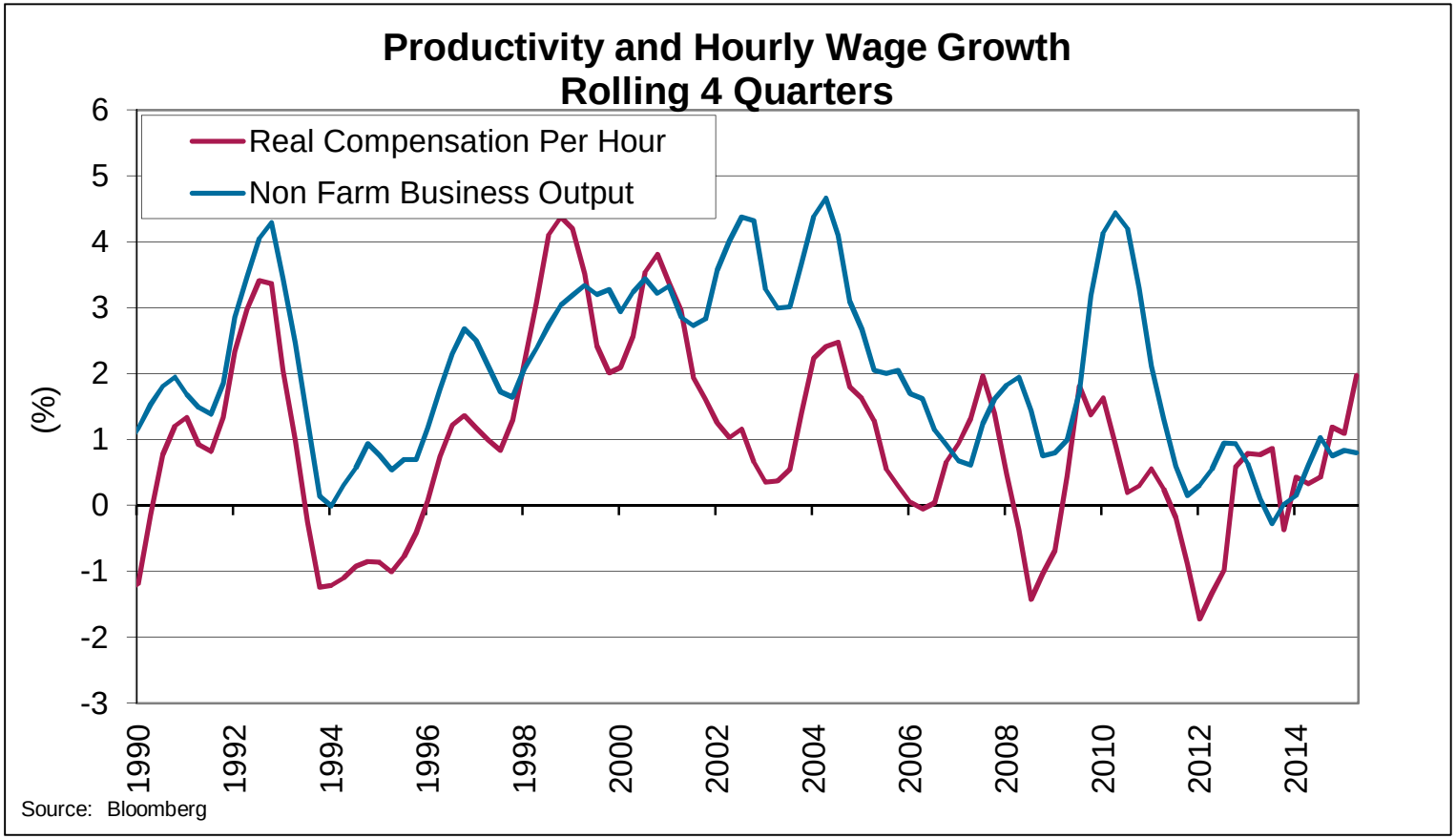
MURKY EARNINGS OUTLOOK FOR US EQUITIES



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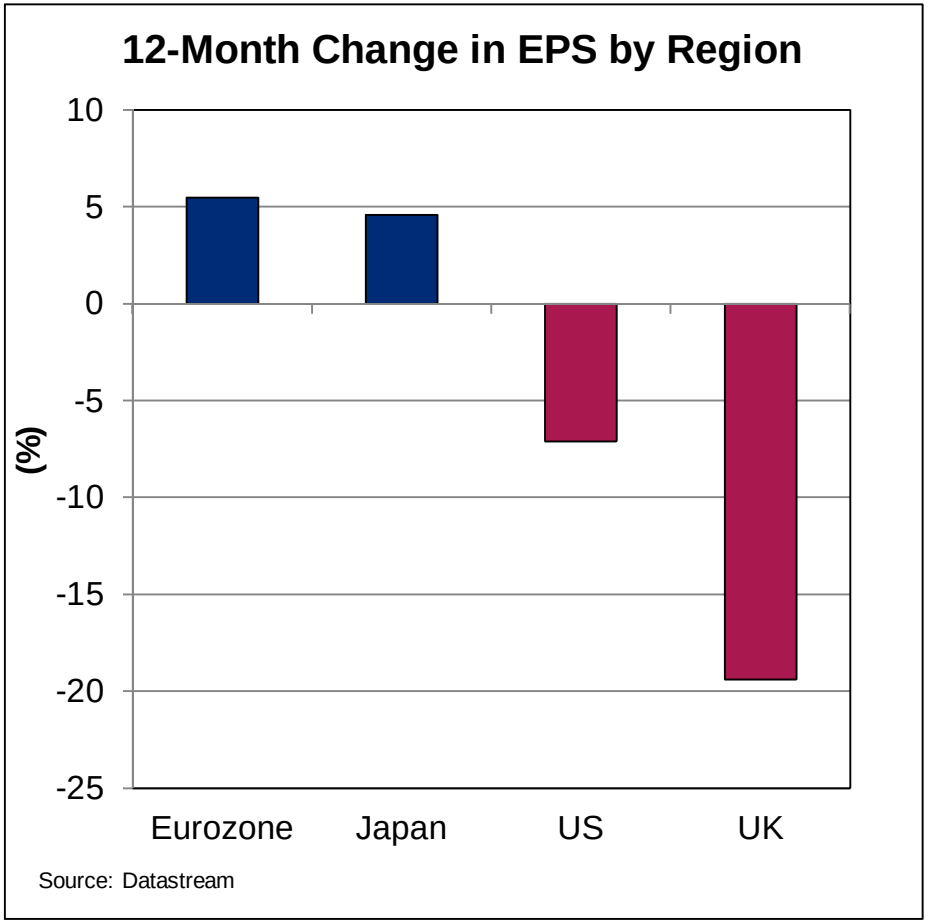
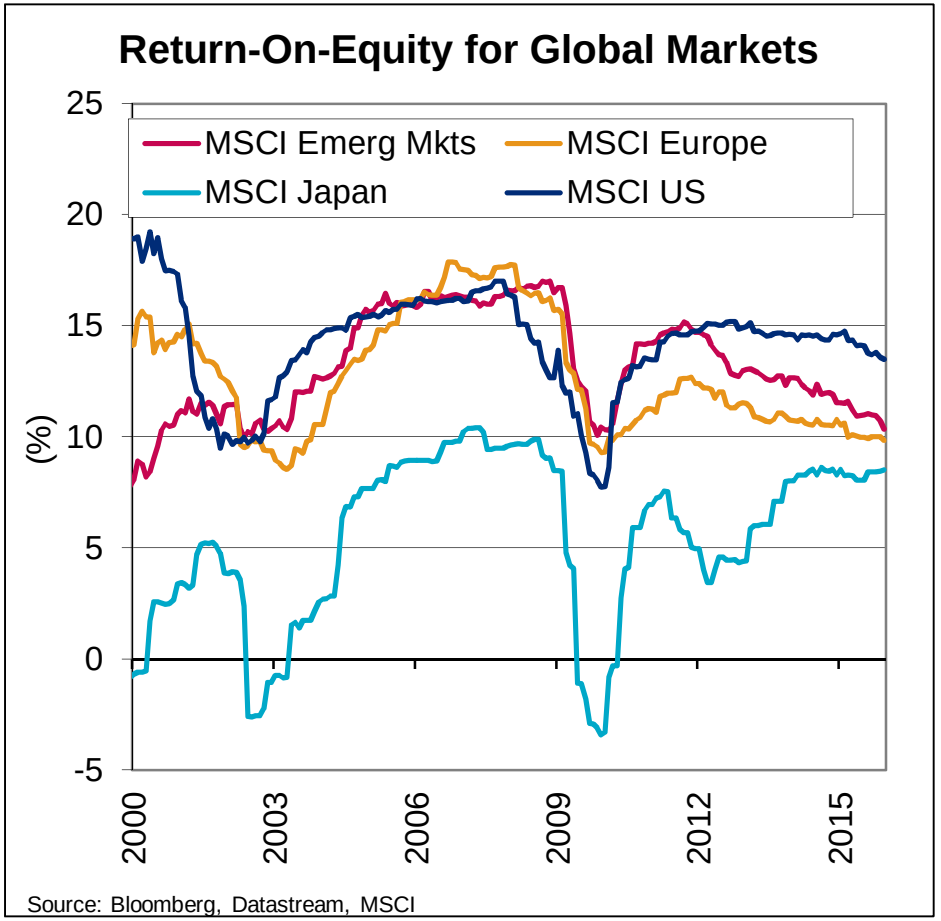
BETTER EARNINGS GROWTH POTENTIAL IN THE EUROZONE AND JAPAN





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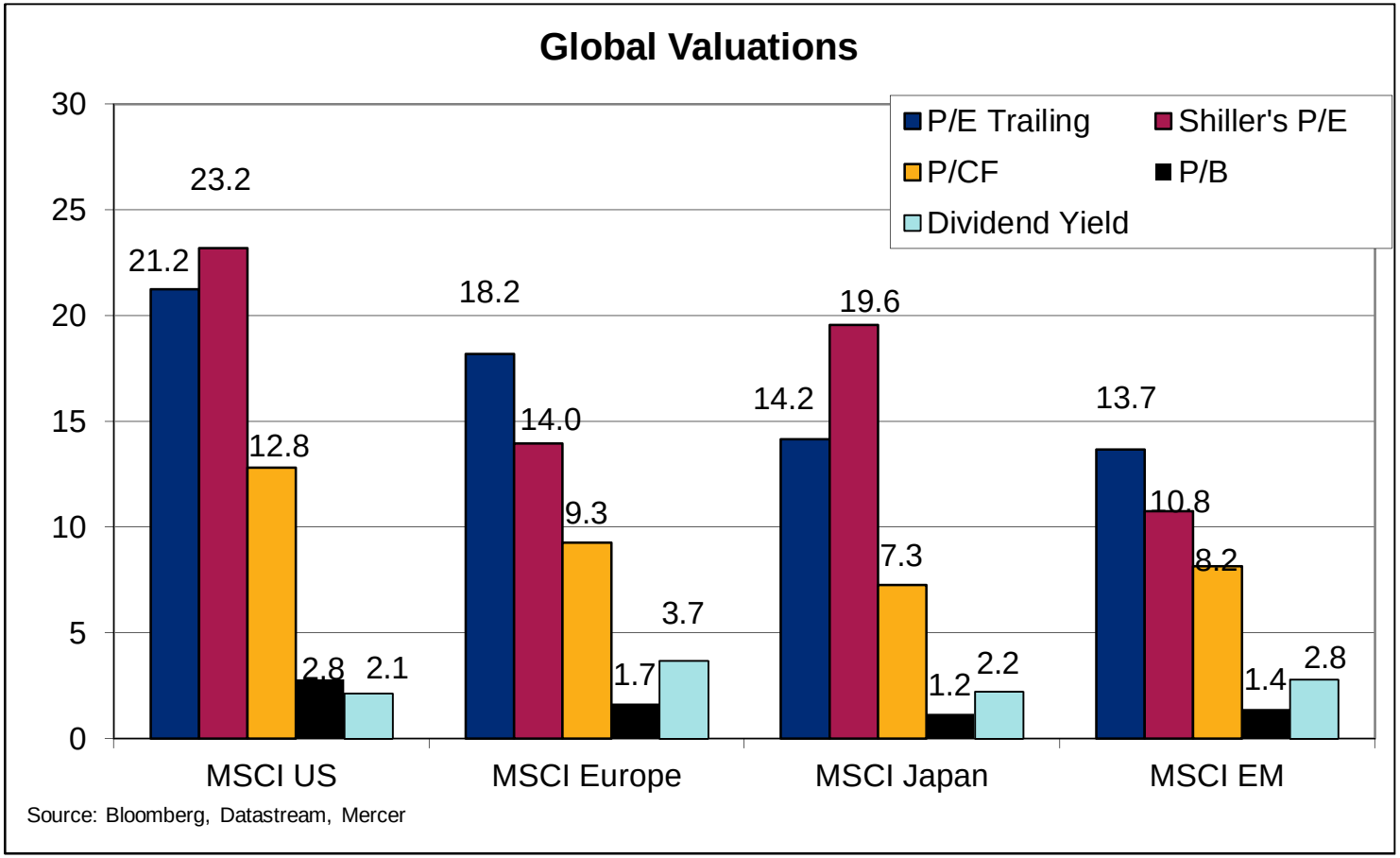
VALUATIONS REMAIN MORE ATTRACTIVE OUTSIDE THE US



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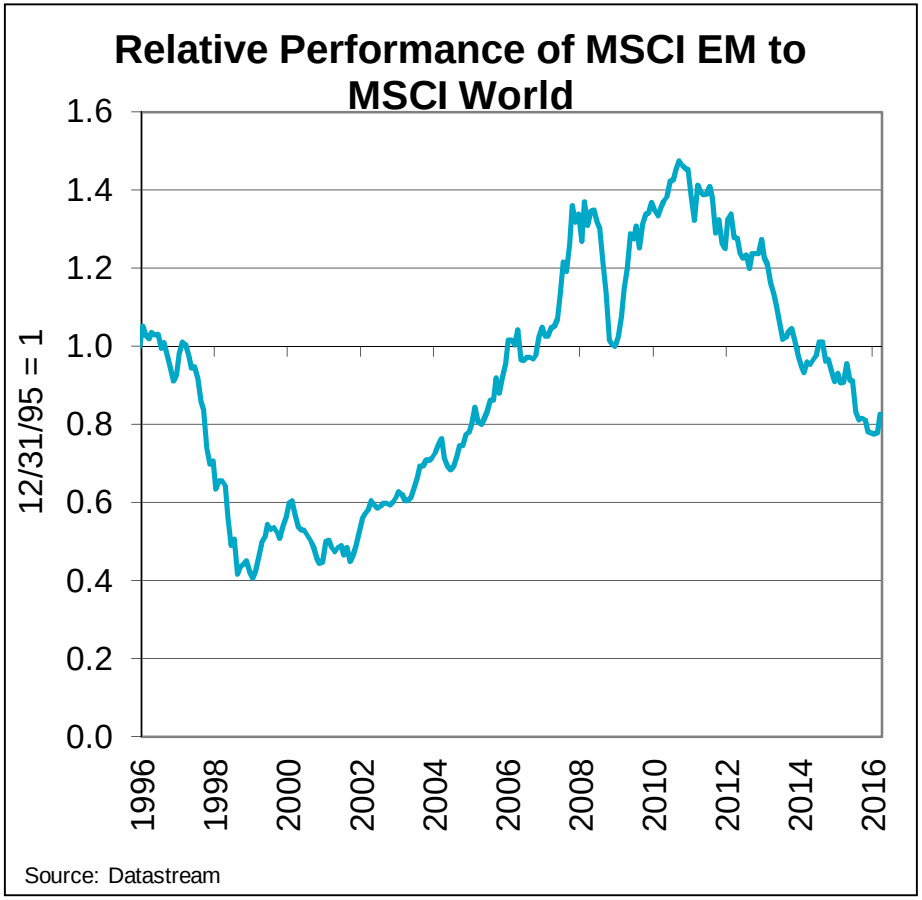
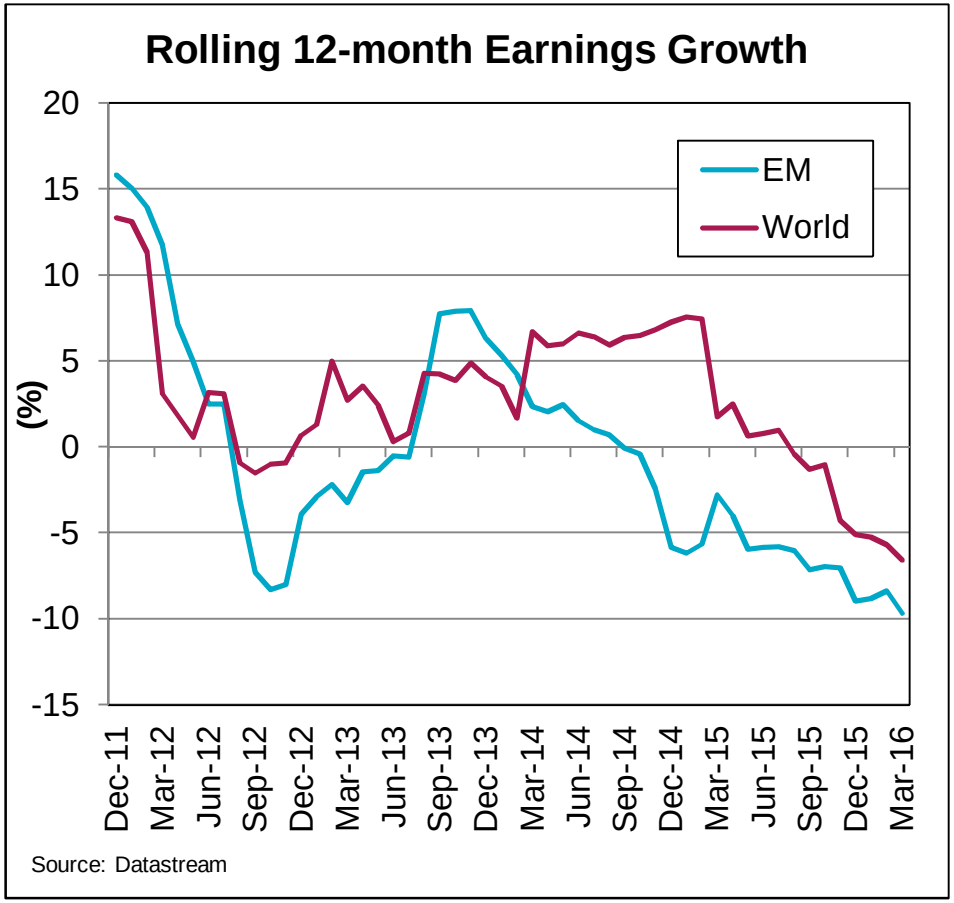
HAVE EM EQUITIES BOTTOMED?





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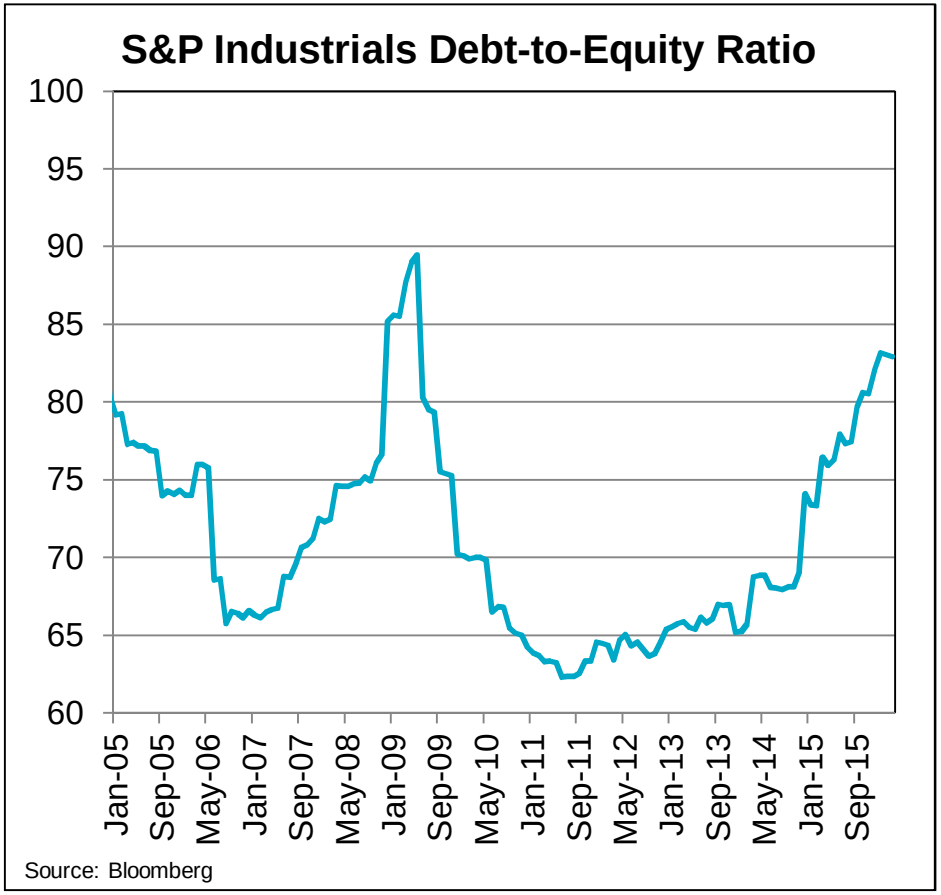
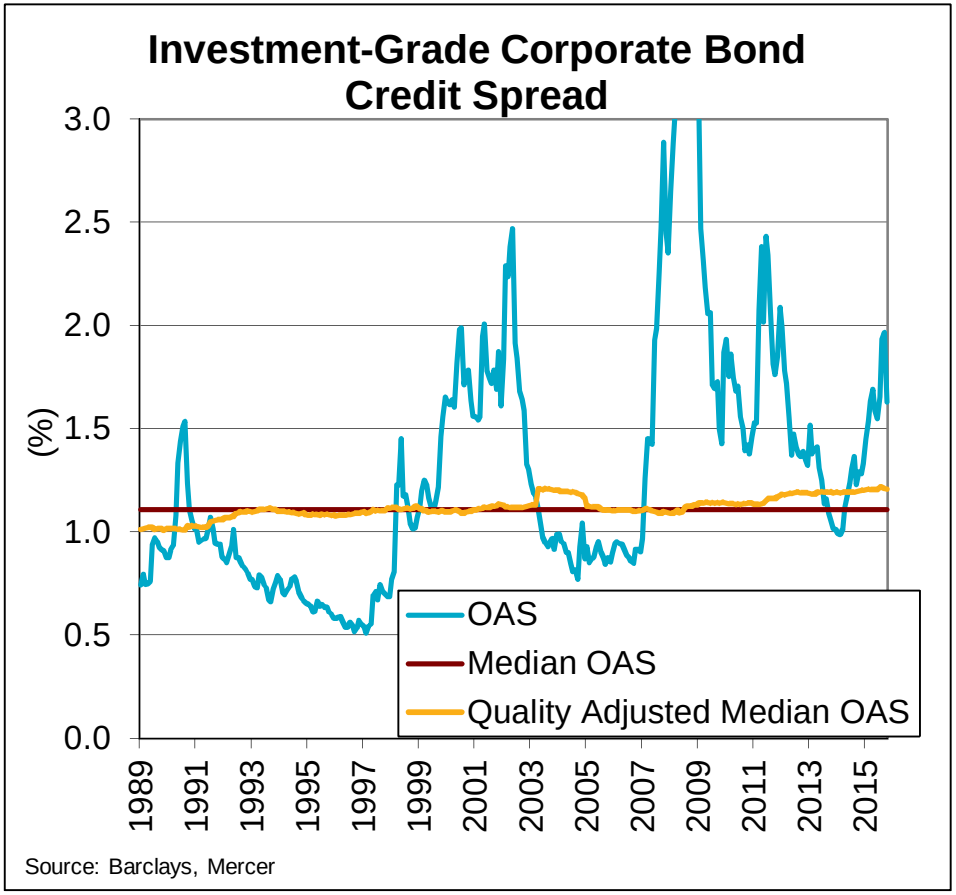
US CREDIT CYCLE: LONG IN THE TOOTH?





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CONCLUSIONS

- Global economy should grow at a moderate pace, but risks tilted to the downside
- Populism is on the rise, further increasing risk
- Central banks have limited maneuverability
- The Fed likely to remain cautious, but inflation edging higher
- Earnings growth may be hard to come by, limiting upside for equities
- Credit is attractive, but corporate fundamentals weakening
- Seek alpha in a low return environment

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US REAL ESTATE UPDATE

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US INSTITUTIONAL REAL ESTATE MARKET REMAINS STABLE

- Interest rates will likely rise slowly, which will prolong the low cap rate environment through 2016 and 2017.
- Appreciation has driven outsized returns in recent years, but as cap rates reach all-time lows, NOI growth will become the primary driver as returns normalize.
- While the recovery has shown depth in gateway markets, it is now reaching a wider breadth. There is increasing evidence that investors are venturing into non-major markets at an increased rate to meet their return objectives.
- The real estate industry as a whole remains stable with strong fundamentals, but defensive strategies are preferable.
- US economic and demographic fundamentals favorable for real estate.
- Real estate performance has been stable relative to other asset classes.

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REAL ESTATE OPTIONS
US INVESTING OVERVIEW

Core

- US safe haven status continues to attract capital to Core Real Estate
- Low lending rates continue to be favorable for investment
- Strong fundamentals are driving NOI growth

Value-Add

- Improvement in fundamentals present further opportunities to fix broken assets
- Opportunities in primary markets are scarce, forcing capital to secondary markets
- Secondary presenting opportunities, but caution should prevail late in the cycle

Opportunity

- NPL and distressed portfolios are scarce in US
- Speculative new developments are decreasing
- Investors continue to eye Europe as NPL source and distress

Debt

- Position in capital stack and high income provide protection
- Investors still active in subordinate debt space
- Opportunity due to recapitalize capital stack is still prevalent

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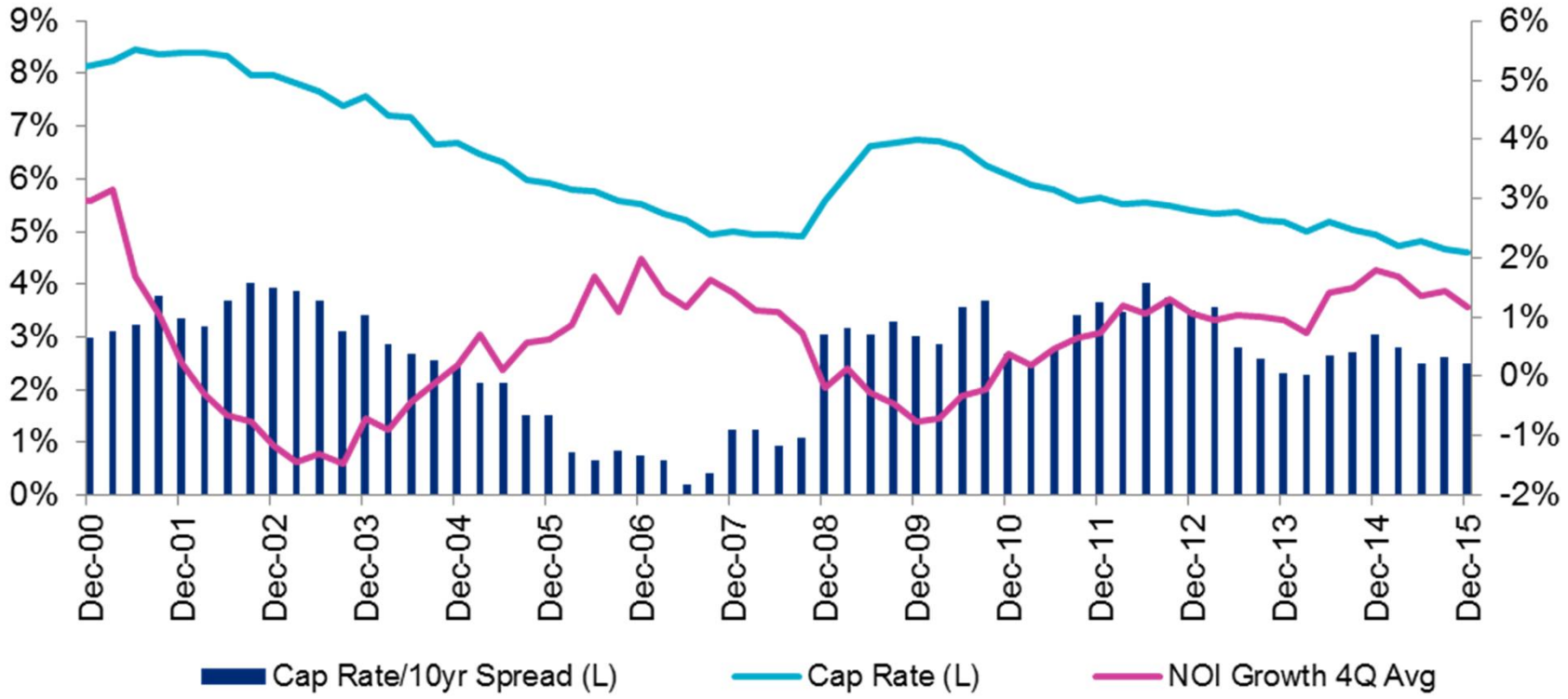
COMBINATION OF LOW CAP RATES AND STRONG NOI GROWTH DRIVING RETURNS

GOING FORWARD, NOI WILL BE PRIMARY DRIVER OF RETURNS



Source: NCREIF, US Treasury

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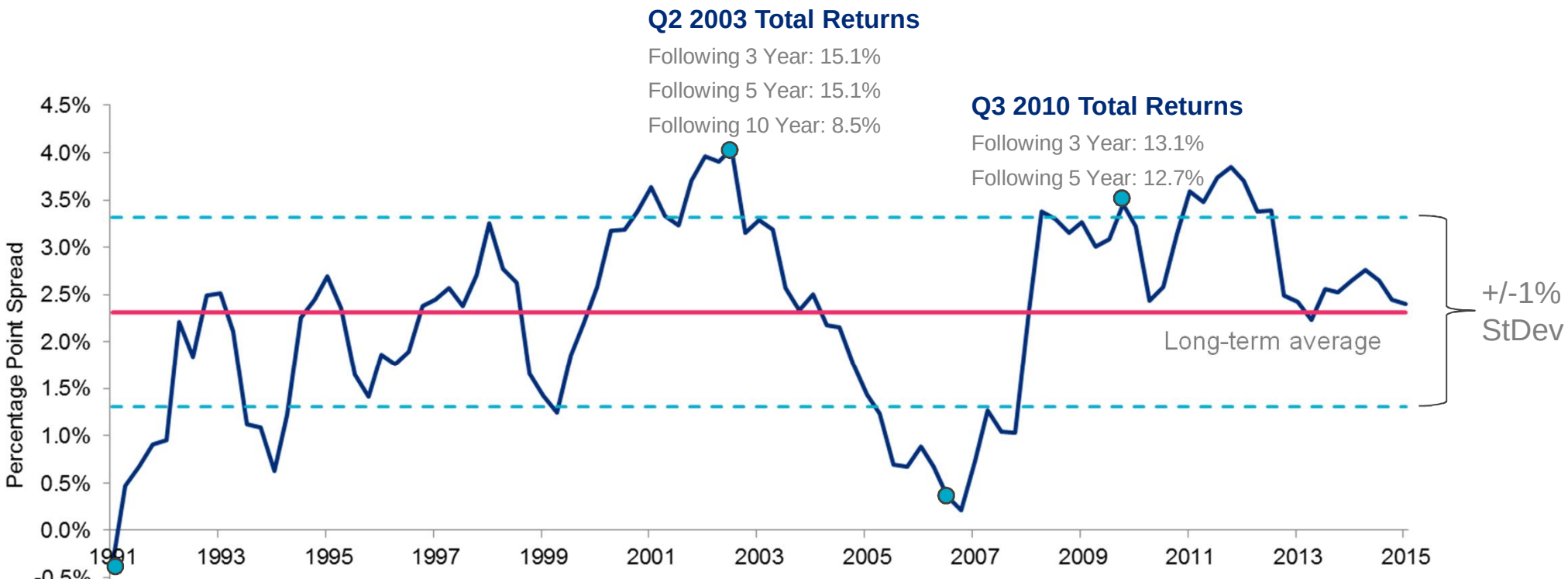
CAP RATE SPREADS TO TREASURIES

STILL SIGNIFICANT CUSHION FOR REAL ESTATE VALUES TO ABSORB A RISE IN INTEREST RATES



Source: NCREIF

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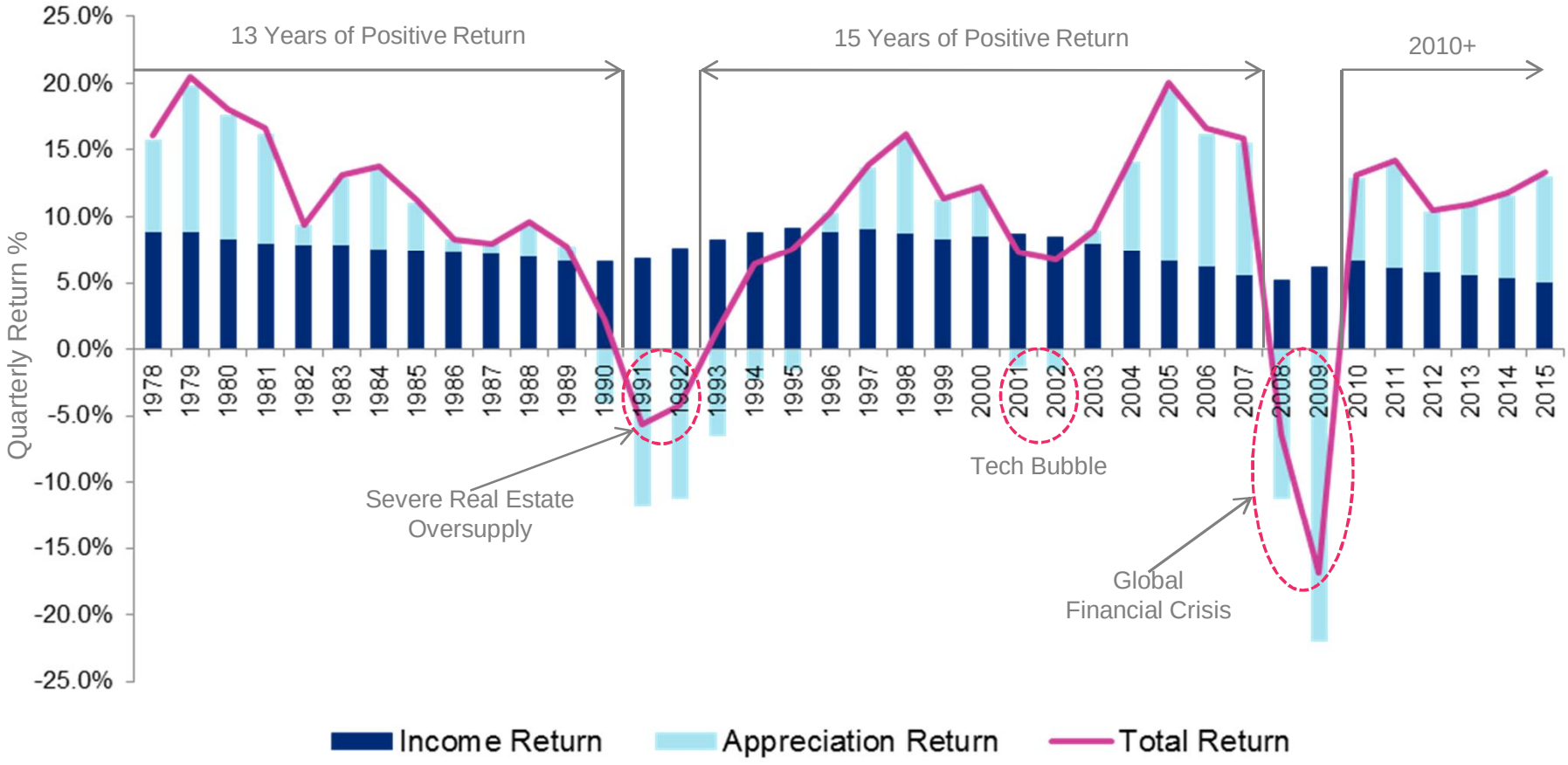
QUALITY REAL ESTATE REMAINS RESILIENT

2015 PROPERTY INDEX TOTAL RETURN OF 13.3%



Source: NCREIF

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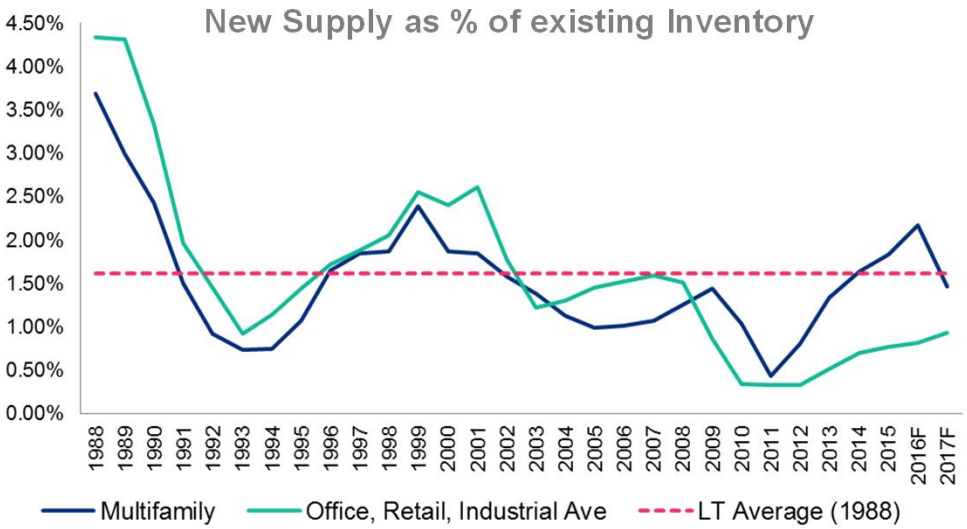
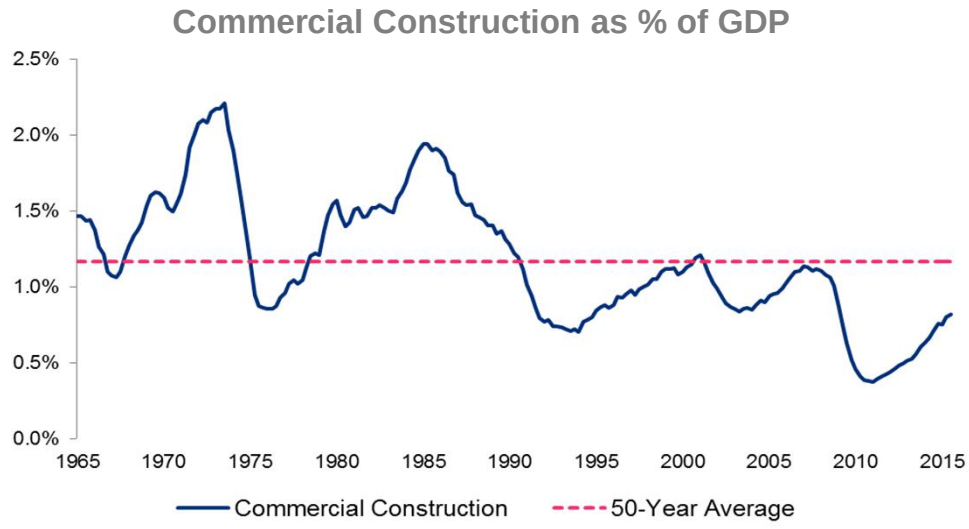
REAL ESTATE FUNDAMENTALS REMAIN BALANCED

- Supply risk remains in balance within most major property types with new construction below historical averages
- Limited new supply coupled with increased demand continues to drive rents and occupancy upward
- As a result, year-on-year rental growth for the commercial sector is forecasted to sustain a level of 4% during 2016





Source: REIS, U.S. Bureau of Economic Analysis

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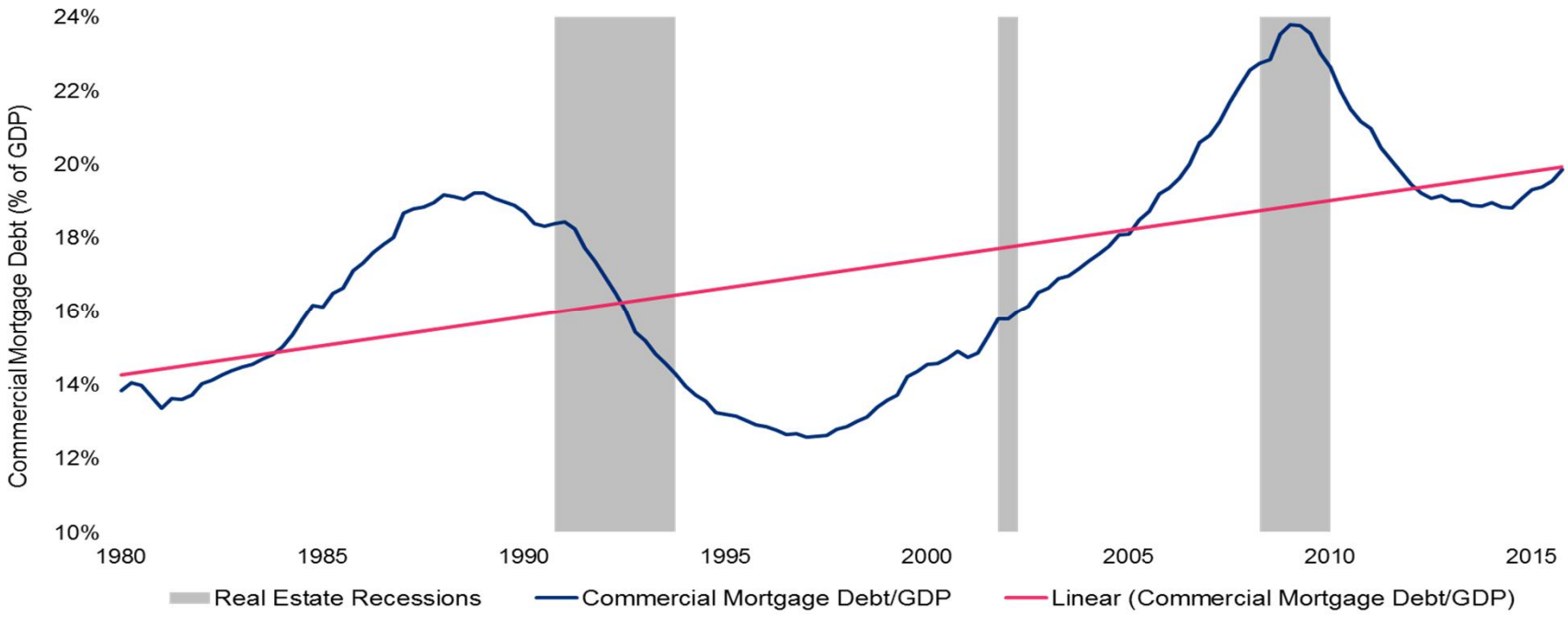
DEBT HAS BEEN INCREASING…

BUT STILL REMAINS BELOW PRIOR PEAK AND IS INLINE WITH HISTORICAL TREND



Source: Federal Reserve; Bureau of Economic Analysis; Deutsche Asset Management

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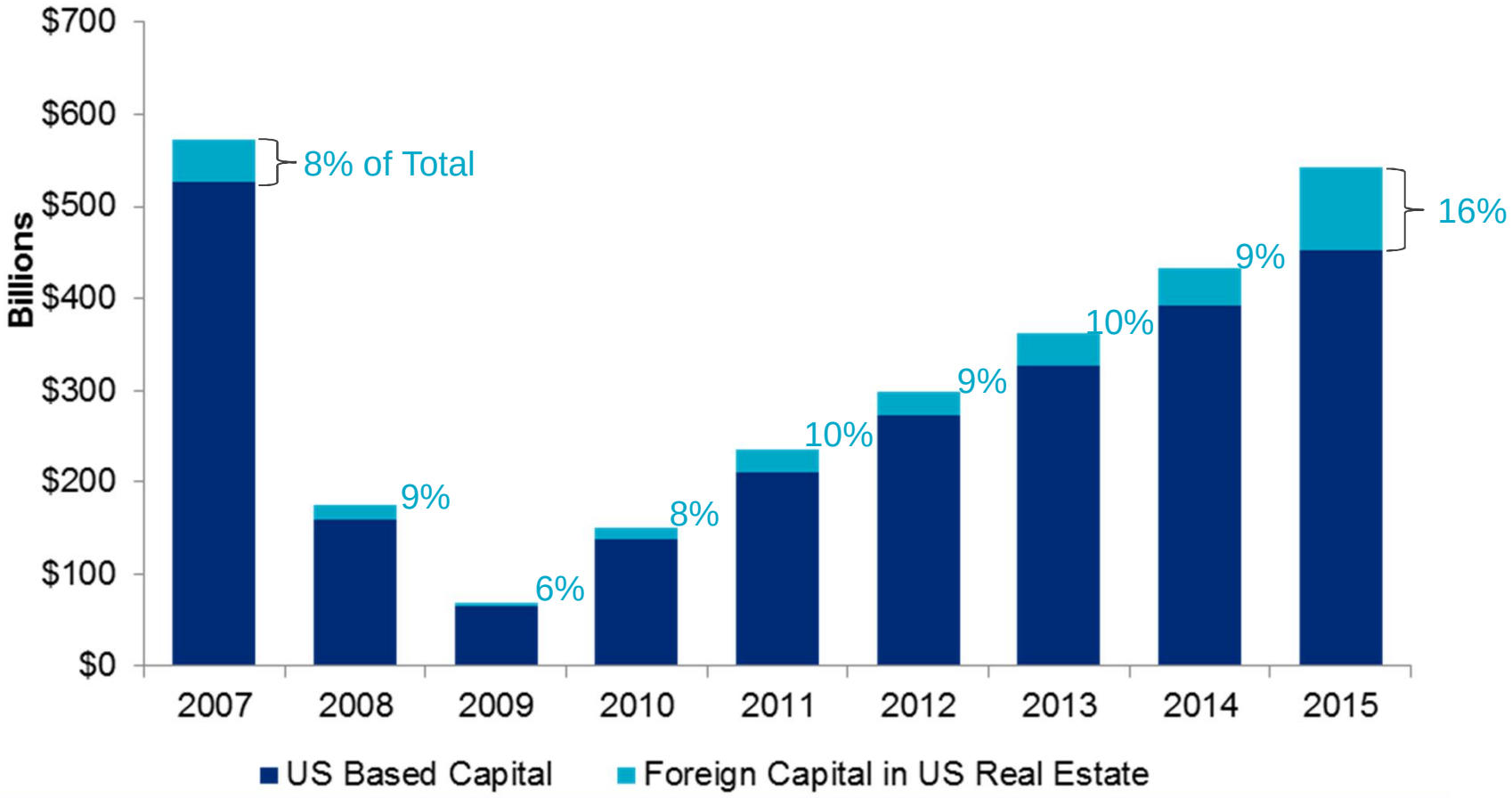
US COMMERCIAL REAL ESTATE TRANSACTION VOLUME

RATIONAL INFLOWS SUPPORTED BY SOUND FUNDAMENTALS



Source: Real Capital Analytics

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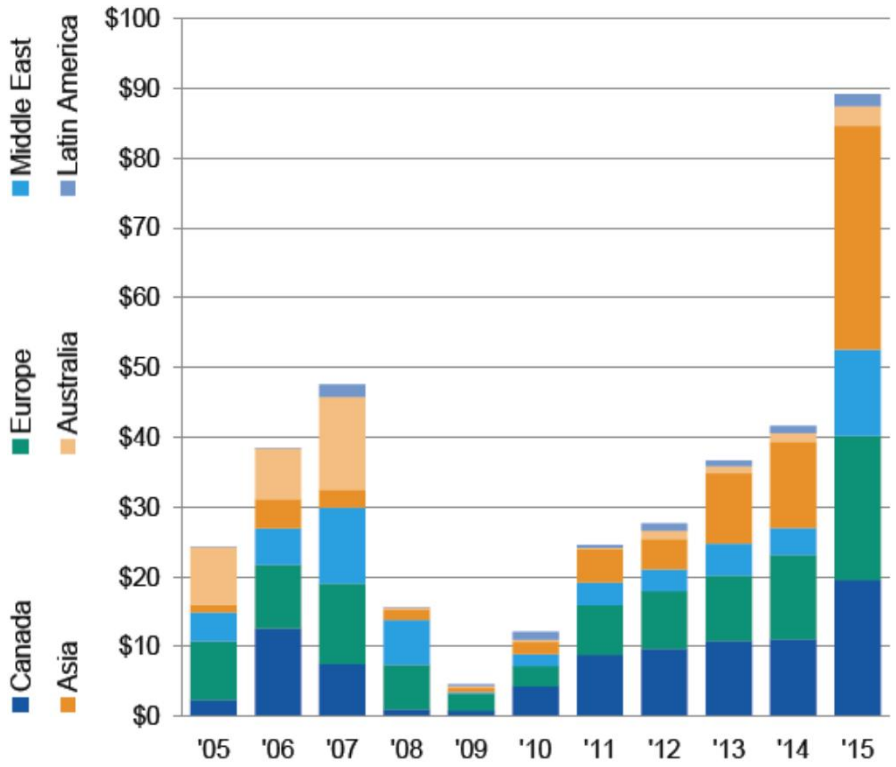
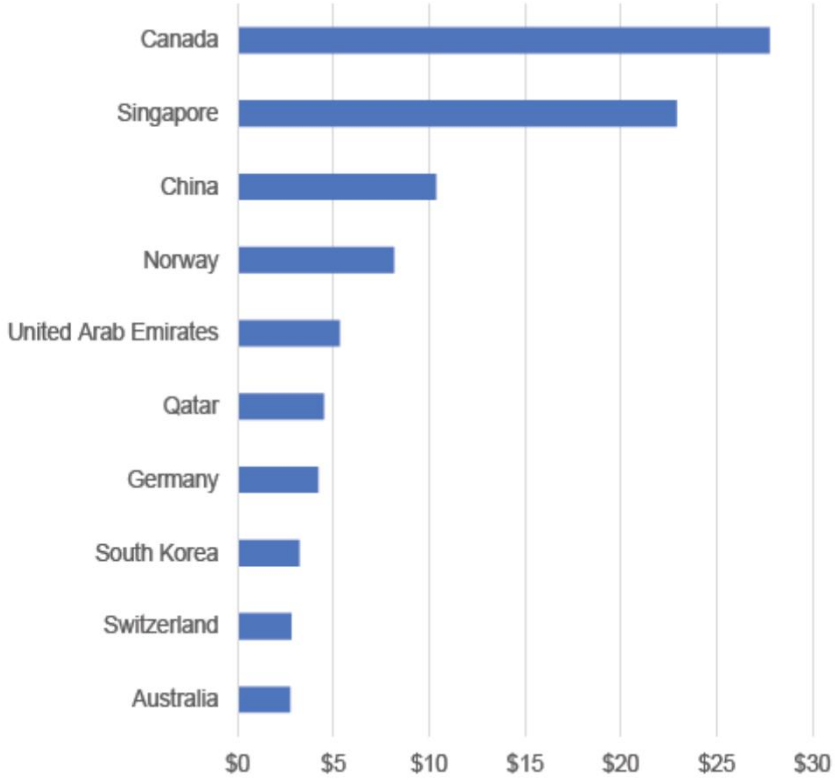
FOREIGN CAPITAL FLOW INCREASING TO US PROPERTY

- Foreign investment almost doubled from 2011 to 2014; and more than doubled again from 2014 to 2015



- Asia Pacific investors continue to target US real estate at increased rate



Source: Real Capital Analytics

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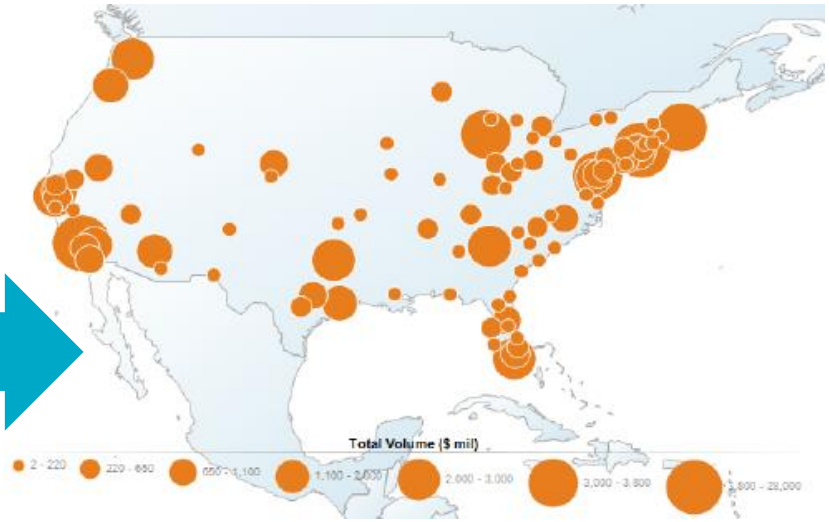
FOREIGN REAL ESTATE INVESTMENT SEARCHING FOR YIELD IN NON-MAJOR MARKETS

INDICATING WE'RE PROBABLY LATE IN THE CYCLE

2014

2015



Source: Real Capital Analytics, AEW

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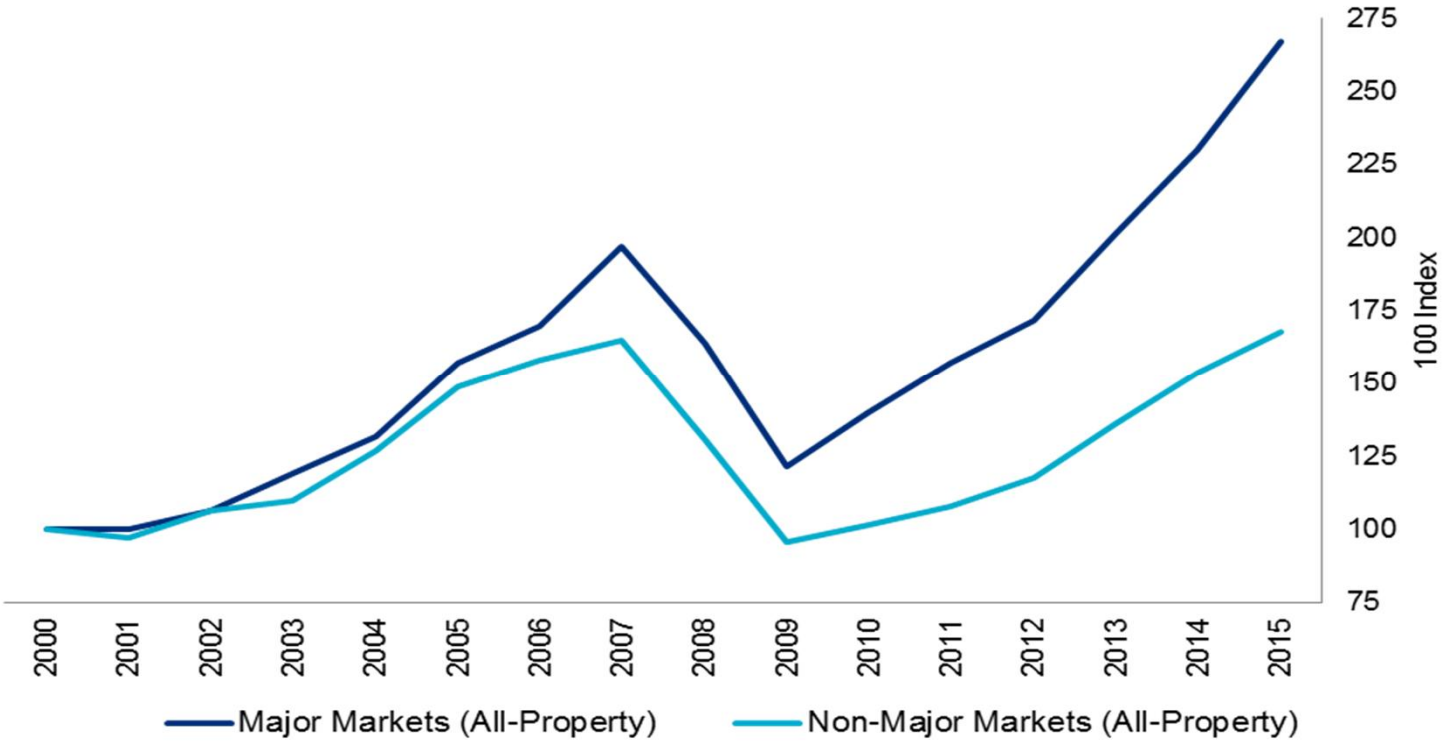
BIFURCATION WIDENS BETWEEN MAJOR AND NON-MAJOR MARKETS

AS A RESULT, NON-MAJOR MARKETS ARE NOW BEING PURSUED AT INCREASED RATE



Source: Real Capital Analytics

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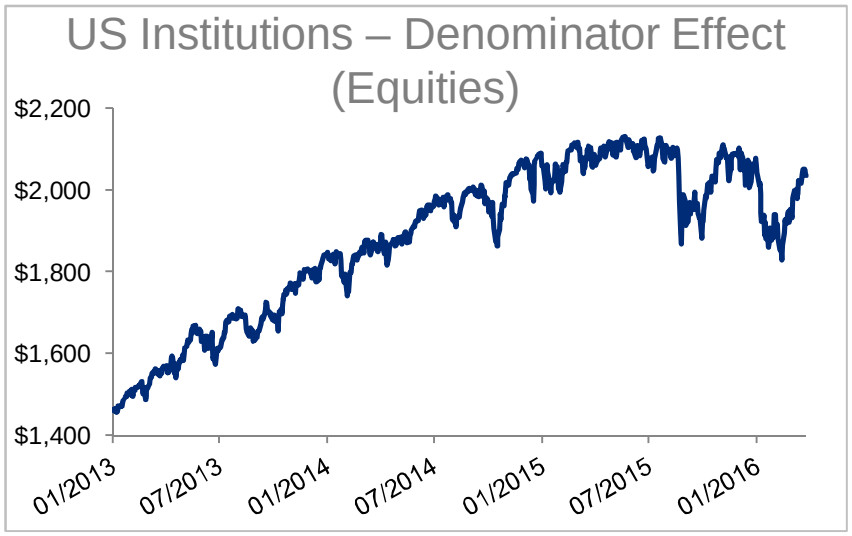
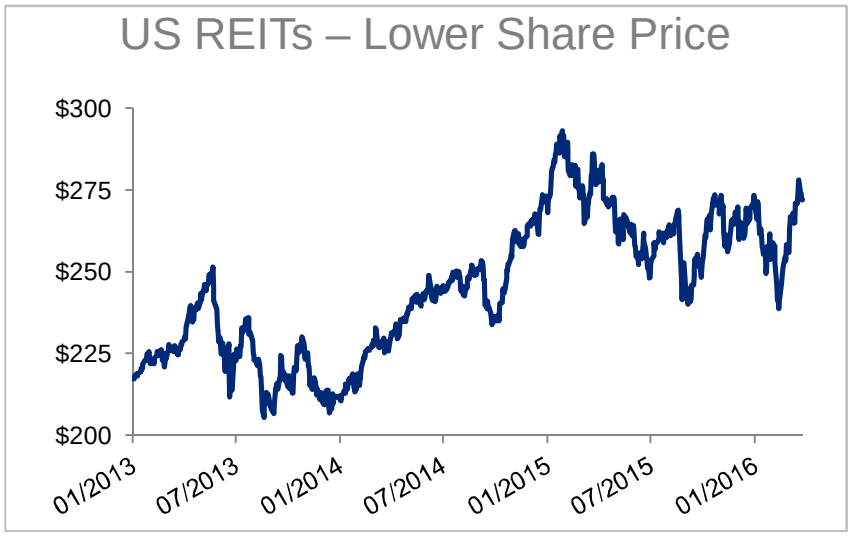
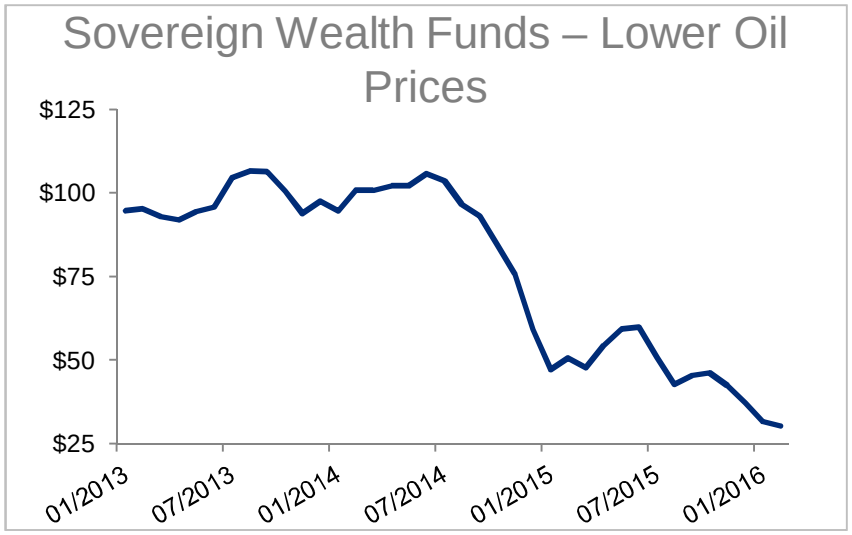
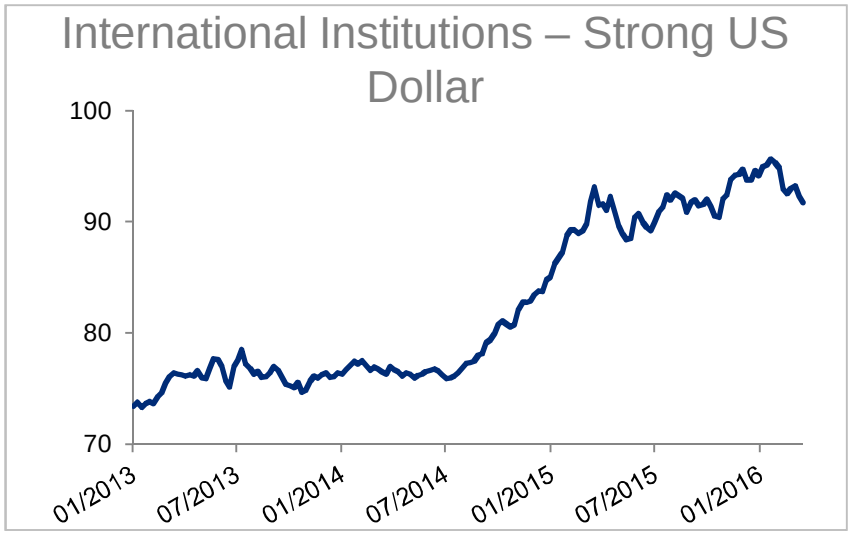
MONITORING CAPITAL SOURCES









Source: 1) S&P 500 2) Wilshire Associates 3) US. Energy Information Administration –WTI 4) Federal Reserve Bank of St Louis

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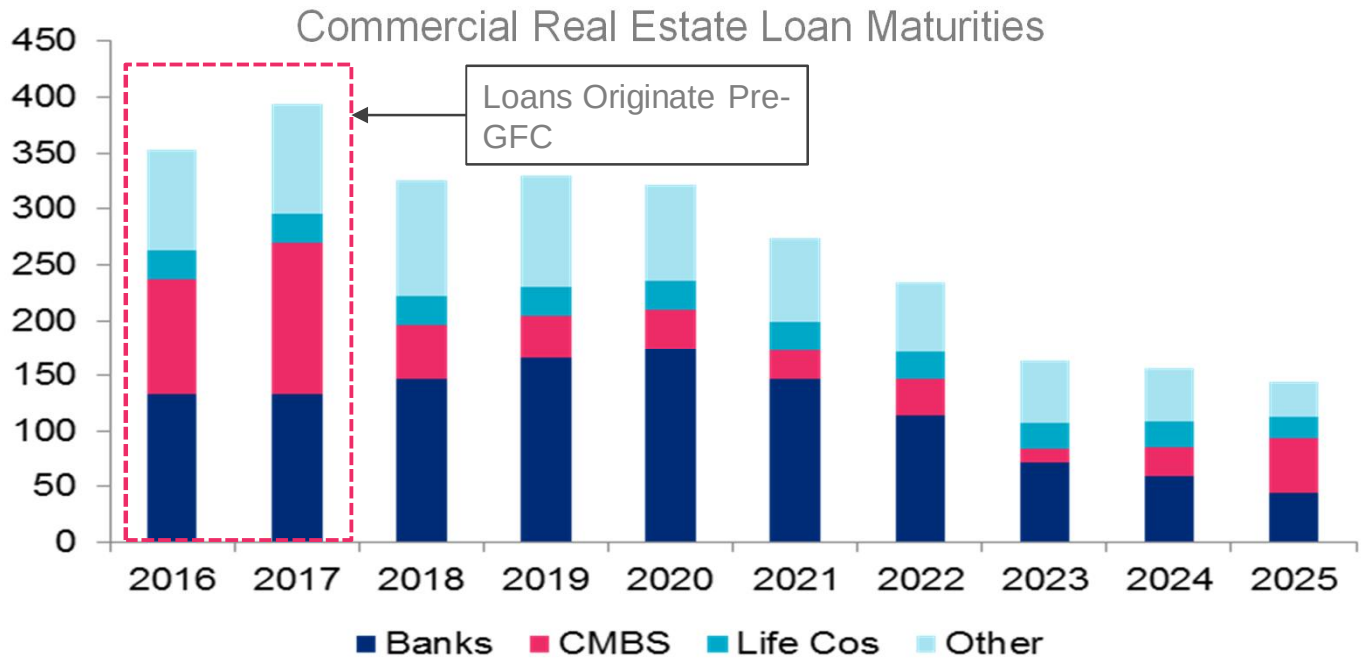
STRESSED EQUITY AND HIGH YIELD REAL ESTATE DEBT

- Pre-GFC loans originated in 2005, 2006, and 2007 are maturing.
- These loans were made at the peak of the market when underwriting standards were low.
- Same banks that provided 80% LTV pre-GFC are now providing ~60%.
- To fill the gap in the capital stack, property owners have to find other sources of capital or sell asset.
- Many of these are assets that have been deprived of capital improvements for 5+ years.
- As an alternative to selling the asset, some owners are turning to the high-yield real estate debt markets to fill the gap.



Source: Federal Reserve, Trepp, Morgan Stanley Research

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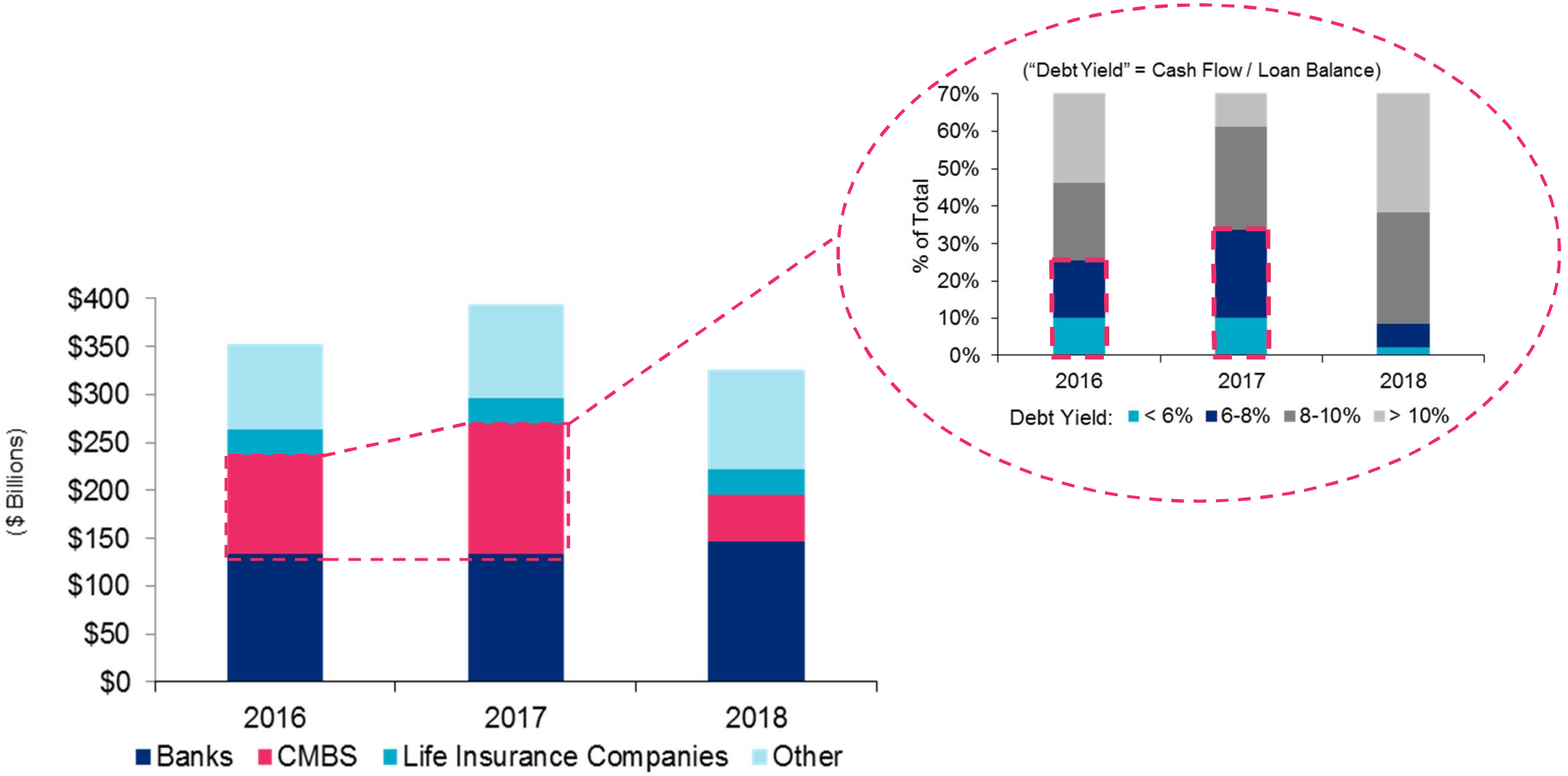
LEGACY CMBS PRESENTING OPPORTUNITIES

DEBT YIELD BELOW 8% SIGNALS DISTRESS



Source: Bloomberg, Morgan Stanley Research, PPR

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QUESTIONS?

Anthony Brown
St. Louis
+1 314 982 5741
anthony.brown@mercer.com

Paul Kolevsohn
Atlanta
+1 404 442 3462
paul.kolevsohn@mercer.com

QUESTIONS

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To submit a question while in full screen mode, use the Q&A button, on the floating panel, on the top of your screen.

CLICK HERE TO ASK A QUESTION TO "ALL PANELISTS"

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