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Benefits of Singapore Real Estate Investment Trusts in a Portfolio

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BACKGROUND

Real Estate Investment Trusts ("REITs") are investment vehicles which hold diversified pools of professionally managed real estate assets, such as shopping malls, offices, hotels or serviced apartments, typically with a view to generate income for unitholders.

In Singapore, the first REIT was launched and listed on the Singapore Exchange in July 2002, and REITs are required to distribute at least 90% of taxable income each year to enjoy certain tax benefits[1].

REITs can be an attractive investment instrument for investors, as it allows potential investors the opportunity to gain access to different real estate properties across different sectors, which may not be possible based on an individual's capital.

THERE ARE BENEFITS TO INVESTING IN REITS

There are multiple benefits of investing in REITs, such as being able to receive a stable income stream due to their requirement to distribute dividends. In this article, we would like to focus on the benefit of using REITs as a portfolio diversifier, and in turn potentially enhance the risk-adjusted returns of an investment portfolio.

DIVERSIFICATION OF PORTFOLIO

In recent years, the correlation between Singapore REITs[2] and Singapore equities[3] has come down quite substantially. Table 1 below illustrates the correlation of Singapore REITs, Singapore equities and Singapore bonds[4] over the last five years:

Table 1: Correlations between November 2012 and October 2017

Nov 2012 to Oct 2017	Singapore REITs	Singapore equities	Singapore bonds
Singapore REITs	1.00		
Singapore equities	0.68	1.00	
Singapore bonds	0.62	0.27	1.00

Index returns are calculated on a total return basis in SGD terms. Past performance is not necessarily indicative of future performance.
Source: Bloomberg, Lion Global Investors; as at October 2017

The correlation currently stands at 0.68. As a comparison, this is down from 0.91 for the previous five years, as illustrated in Table 2 below:

Table 2: Correlations between November 2007 and October 2012

Nov 2007 to Oct 2012	Singapore REITs	Singapore equities	Singapore bonds
Singapore REITs	1.00		
Singapore equities	0.91	1.00	
Singapore bonds	-0.17	-0.20	1.00

Index returns are calculated on a total return basis in SGD terms. Past performance is not necessarily indicative of future performance.
Source: Bloomberg, Lion Global Investors; as at October2017

[1] *Source: http://www.moneysense.gov.sg/understanding-financial-products/investments/types-of-investments/real-estate-investment-trusts.aspx*
[2] *Representative index used: FTSE Straits Times REIT Index*
[3] *Representative index used: FTSE Straits Times Index*
[4] *Representative index used: iBoxx ABF Singapore Total Return Index*

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We believe that the decrease in correlation between Singapore REITs and Singapore equities can be largely attributed to the growing maturity of REITs as an asset class. REITs, which started in Singapore in 2002[5], were still in an infancy stage prior to 2012.

In recent years, we have seen more REITs listing in Singapore (for example, based on our research we saw only six listings between 2008 and 2012, while there were 14 listings since 2013). As REITs become more established as an asset class on its own, and investors' interests in REITs increased, REITs have increasingly traded in line with their sector- and stock-specific catalysts, rather than just following the general market trends, in our view. This is further amplified by the increased number of funds and products created to invest in REITs. As the asset class continues to mature, we believe that the trend of a decreased correlation between REITs and equities will continue going forward.

We also note, on the other hand, that the correlation between Singapore REITs and Singapore bonds have gone up. In our view, this could be caused by the low interest rates environment, which has seen investors turn to REITs as a replacement for bonds in their search for yield.

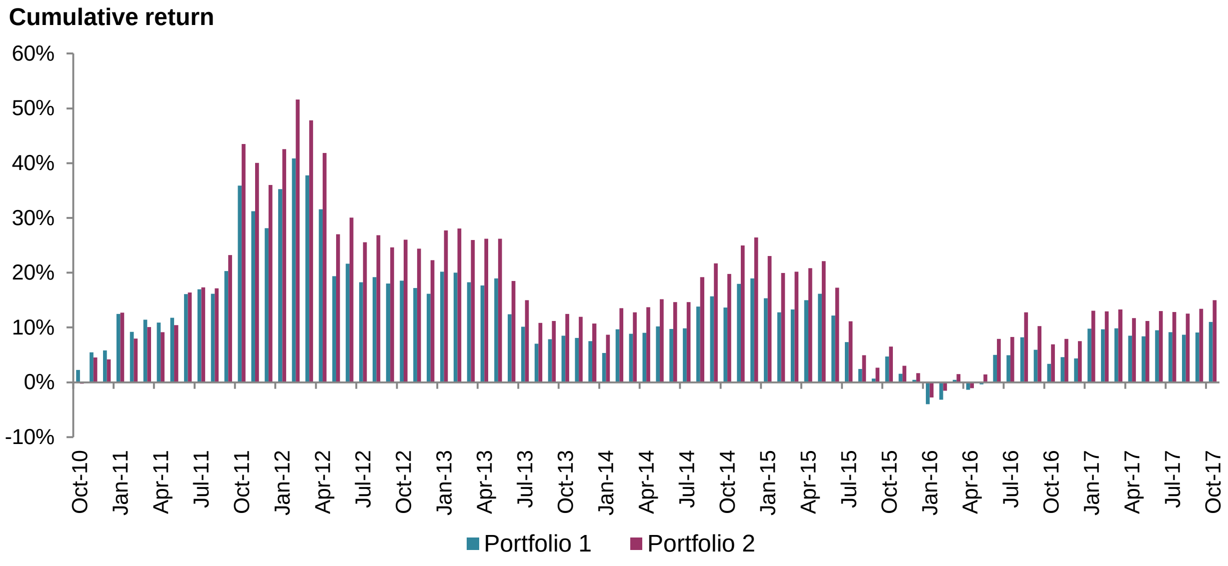
Overall, Singapore REITs have an imperfect correlation against both equities and bonds. Combining assets with low performance correlation in an investment portfolio can help to potentially reduce overall portfolio risk without sacrificing potential return. We look deeper into this by putting together portfolios using the above three asset classes.

ENHANCING PORTFOLIO RETURNS

Using a Singapore balanced portfolio (i.e. an equal combination of Singapore equities and Singapore bonds) as the basis for comparison, we find that adding a small allocation to Singapore REITs can potentially help to boost the portfolio returns. Chart 1 below illustrates the cumulative return for each rolling 3-year period for the following two types of allocations:

1. Portfolio 1 – 50% allocation each into Singapore equities[6] and Singapore bonds[7]; and
2. Portfolio 2 – 20% allocation into Singapore REITs, and 40% allocation each into Singapore equities and Singapore bonds.

Chart 1: 3-year cumulative rolling returns



Based on historical returns calculated in SGD terms for the 10-year period from November 2007 to October 2017. Past performance is not necessarily indicative of future performance. Opinions and estimates constitute our judgment and along with other portfolio data, are subject to change without notice.
Source: Bloomberg, Lion Global Investors; as at October 2017

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[5] *Source: http://www.moneysense.gov.sg/understanding-financial-products/investments/types-of-investments/real-estate-investment-trusts.aspx*
[6] *Representative index used: FTSE Straits Times Index*
[7] *Representative index used: iBoxx ABF Singapore Total Return Index*

As shown in Chart 1, Portfolio 2, which includes a 20% allocation to Singapore REITs, generally outperformed Portfolio 1 (without Singapore REITs allocation) since 2012, on a 3-year cumulative rolling returns basis. We believe the lower correlation between Singapore REITs and Singapore equities since 2012 helps to diversify some of the portfolio risk and enhance risk-adjusted returns on an overall basis.

CONCLUSION

For Singapore investors looking to optimise their returns by gaining exposure to different asset classes locally, Singapore REITs could potentially be a good portfolio diversifier to enhance overall returns.

THE LION-PHILLIP S-REIT ETF

The Lion-Phillip S-REIT ETF (SGX stock code: CLR) is designed to provide investors with a low-cost access to 23[8] high-quality S-REITs that offers a sustainable income stream.

The Lion-Phillip S-REIT ETF aims to replicate as closely as possible the performance of the Morningstar® Singapore REIT Yield Focus Index℠, which draws on Morningstar's independent research, global data and deep indexing expertise.

For more information on the Lion-Phillip S-REIT ETF, please visit http://www.lionglobalinvestors.com/en/disclaimer-etf.html.

[8] *As at 31 October 2017. S-REITs are securities constituting the Morningstar® Singapore REIT Yield Focus Index℠. The number of S-REITs that constitutes the Index may be changed by MorningstarResearch Pte Ltd from time to time.*

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