Please note that the commentary is for the retail class of the fund.

The All Property Index (ALPI) delivered a total return of -6.2% for the fourth quarter (Q418), lagging the FTSE/JSE All Share Index's (ALSI) -4.9% return and the All Bond Index's (ALBI) 2.7%. The correlation between bonds and listed property broke down during the quarter. The SA 10-year government bond yield was largely unchanged at 9.2% from a quarter earlier, while the forward yield of the ALPI saw an increase to 9.4% from 8.8% at the end of September. The historical yield of the bellwether index[1] increased to 9.6% at the end of the quarter, from 9.1% three months earlier. This saw the historical yield gap relative to bonds widen to 38 basis points (bps) at the end of December from 15bps at end-September. Listed property's total return for the 2018 calendar year came in at -25.3% - behind bonds, which returned 7.7% and the ALSI's -8.5%.

The fund's return of -5.8% during the quarter was ahead of the -6.2% delivered by the benchmark. The fund's performance over periods between three and 10 years compares favourably to peers and the benchmark. Value add during the quarter came from the fund's relative positioning in Hyprop, Stor-Age, Resilient and Fortress B. These were enough to offset the value detraction coming from the fund's relative positioning in Attacq, Liberty Two Degrees, Hammerson and Growthpoint. During the period, the fund increased exposure to Redefine, Growthpoint and Hammerson, while reducing exposure to a handful of names, including Liberty Two Degrees, SA Corporate and Equites.

The past quarter saw the conclusion of the last reporting period of the year. Trends from the earlier results season were cemented as several companies downwardly revised guidance owing to the continued lacklustre economic activity, while companies with once-offs in their earnings bases continue to try to wean themselves off these. Overall, dividend per share (DPS) growth for the second- half reporting season came in at 8.1% including offshore names but registered 4.3% excluding these. Reversions across the sectors were under pressure, although vacancies generally held steady as landlords prioritised tenant retention over rental growth. On the cost side, the City of Johannesburg's municipal valuations remain topical: increased rates bills have seen pressure on expense ratios as landlords have been unable to pass the entire increases to tenants.

Numerous management changes took place during the quarter. Hyprop announced that long-serving CEO, Pieter Prinsloo, would be leaving the company at the end of 2018, and would be replaced by current MAS CEO (and former Attacq CEO), Morne Wilken. Pieter Prinsloo will be joining Redefine Europe in the Netherlands. Morne's position at MAS will be filled in the interim by current CFO, Malcolm Levy. Meanwhile, Fortress announced that Mark Stevens would be stepping down as CEO over the next 12 months, with current acting CFO, Steven Brown, identified as his successor. Similarly, at Gemgrow it was announced that Mark Kaplan would be stepping down as CEO in the coming year. Mark also serves as the CEO of Gemgrow parent company Arrowhead, and it was always envisioned his role at Gemgrow would be of a short-term nature in the company's initial years until a solid management capability was established.

Following an unsuccessful merger attempt with rival Hammerson earlier in the year, Intu was the target of another corporate action effort. A consortium comprising the company's largest shareholder, the Peel Group, the Olayan Group and Brookfield, had shown intentions to take Intu private. Following two extensions to the Takeover Regulatory Panel (TRP) deadlines to make a firm offer or walk away, the consortium eventually chose not to proceed with the offer, citing continued uncertainty around macroeconomic condition, this following sluggish progress in Brexit negotiations. On the local front, Texton's shareholders voted against the exercise of a PIC PUT option that would have seen shares used as collateral for the BEE loan bought back by the company. With this vote outcome, legal advice received by the company is that the PUT option has now fallen away.

The South African Property Owners Association (SAPOA) released its quarterly office vacancy survey for the third quarter of 2018. The release showed that office vacancies increased to 11.2% in September 2018 from 11.1% a quarter earlier. Of the four office grades, only A-grade space saw improved vacancy trends, with vacancies improving 40bps to 8.9%. P-grade space saw a marked deterioration of 120bps to record a 6.7% vacancy rate, while B- and C-grade offices saw vacancy rate increases of 40 and 50bps respectively to 14.2% and 15.4%. Of the five metropolitan areas, three (Durban, Pretoria and Port Elizabeth) registered improvements in occupancies while two (Johannesburg and Cape Town) saw worse vacancy trends. Growth in asking rents over the last 12 months recorded a slowdown to 5.3% compared to 6.3% in the previous quarter. Office space under development amounts to 2.9% of existing stock (with 45.2% of this pre-let). A high degree of concentration remains, with 10 of the 53 nodes accounting for 93% of all developments. Thirty-three percent% of this space is in the Sandton node.

While GDP figures showed a rebound in the third quarter of 2018, this is yet to reflect in underlying property fundamentals. It remains unclear how long the weak property fundamentals will remain in place, but some uncertainty is likely in the offing ahead of this year's general elections. As a result, opportunities within the SA listed property universe remain selective. While initial yields appear attractive, already under-pressure distribution growth could see further headwinds, making the attractiveness of the sector less than it appears, though earnings expectations incorporate these weaker fundamentals.

Portfolio manager
Anton de Goede and Kanyane Matlou
as at 31 December 2018

[1] Index comprising the following counters: Growthpoint, Redefine, Hyprop, Vukile, SA Corporate and Investec Property Fund