

0412 | 2019

ASIA CHART OF THE WEEK

Risk management through lower portfolio correlation

The first quarter of 2019 saw an increase in risk appetite globally. Developed and Emerging market assets were simultaneously bid up. While this was a welcomed reprieve from the market decimation in December 2018, it also brought back heightened correlation between assets and regions. Therein lies the issue...markets that rise together, fall together.

In portfolio construction, piecing together low and/or negatively correlated assets adds to performance over time by helping to manage the downside risk

Over the last 20 years, US Private Real Estate has proven to be a key diversifier. Key reasons include stable cash flows, and benefiting from several well-identified socioeconomic and demographic trends (e-commerce, logistics, consumption, family patterns, green living) that are translating into strong demand for various types of real estate in the US.

As at 31 December 2018, US Private Real Estate displayed desirable (low and negative) correlations with asset classes in the US and globally.

The bottom line

Institutional investors such as education endowment funds* have been using US Private Real Estate to great effect; managing risks and enhancing long term returns. A large part of that ability comes from lowering correlation within the portfolio which over time, can have drastically positive impact on returns.

Chart: US Private Real Estate (NCREIF NPI) displays desirable correlations with US and global asset classes (31 March 2009 to 31 December 2018)

Note: Blue shades are desirable due to low or negative correlation.

Correlation (31 March 1999 to 31 December 2018)	US Private Real Estate	US REITs	US Large Caps	US Small Caps	US Bonds	International ex. US Equities
US Private Real Estate	1.00	0.25	0.19	0.16	-0.12	0.16
US REITs	0.25	1.00	0.63	0.69	0.06	0.58
US Large Caps	0.19	0.63	1.00	0.92	-0.40	0.87
US Small Caps	0.16	0.69	0.92	1.00	-0.39	0.82
US Bonds	-0.12	0.06	-0.40	-0.39	1.00	-0.27
International ex. US Equities	0.16	0.58	0.87	0.82	-0.27	1.00

Note: The NCREIF Property Index (NPI) 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. Please visit <https://www.ncreif.org/data-products/property/> for more information.

Source: Legg Mason, Bloomberg, MSCI, FTSE, Standard and Poor's, National Council of Real Estate Investment Fiduciaries. 12 April 2019. Data as of 31 December 2018, unless stated otherwise. Returns in USD. *<https://news.yale.edu/2018/10/01/investment-return-123-brings-yale-endowment-value-294-billion>. US Private Real Estate refers to the NCREIF Property Index. US REITs refer to the FTSE National Association of Real Estate Investment Trusts (NAREIT) All Equity REITs Index. US Bonds refer to the Bloomberg Barclays US Aggregate Bond Index. US Large Caps refer to the S&P 500 Index. US Small Caps refer to the Russell 2000. International ex US Equities refer to the MSCI EAFE index. Past performance is no guarantee of future results. Please note that an investor cannot invest directly in an index. Unmanaged index returns do not reflect any fees, expenses or sales charges.

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