FIRST ASSET CANADIAN REIT ETF
MANAGER COMMENTARY
March 2019
TSX: RIT

Portfolio Activity and Market Commentary

Real estate investment trust (REITs) outperformed broader North American markets in March, capping off a solid first quarter of 2019. The S&P/TSX Capped REIT Index was up 3.8% for the month ended March 31, versus 1.0% for the S&P/TSX Composite Index, 3.3% (in U.S. dollars) for the MSCI US REIT Index and 1.9% (in U.S. dollars) for the S&P 500 Index. Year-to-date, the S&P/TSX Capped REIT Index is up 15.8%, outpacing the 13.3% return for the S&P/TSX Composite Index. For the month, First Asset Canadian REIT ETF (the "Fund") returned 3.2%, net of fees.

Despite the rebound off the December 2018 lows, REITs, on average, have continued to trade at a discount to consensus net asset value (NAV). We continue to see significant divergence in valuation by issuer and property type, and we remain biased toward REITs and real estate operating companies with quality, well-located assets; strong balance sheets; above-average net operating income, NAV per unit and adjusted funds from operations per unit growth profiles that are attractively valued versus peers and/or direct property. In the current environment, it is increasingly important to be selective, and we have continued to recycle capital accordingly, adding exposure where we perceive mispricing/better growth. Real estate operating fundamentals remain healthy across most markets and asset classes, particularly for multi-resident and industrial classes. Recent earnings call commentary, meetings with management, investor days and industry conference dialogue continue to point to positive same property net operating income growth despite broader concerns relating to a slowing economy.

The 10-year Canada bond yield finished the month at 1.62%, down 35 basis points (bps) since December 31, 2018 and down 98 bps since its peak on October 5, 2018. On March 22, 2019, the U.S. 10-year to 3-month yield curve inverted for the first time since 2006. The inversion also emerged in Canada. Over the past 50 years, the U.S. 10-year to 3-month yield curve has inverted on a number of occasions: 1969, 1973, 1978, 1989, 1998 and 2006. Historically, 10-year to 3-month inversions have typically – but not always – coincided with a chain of events that ultimately led to a recession, quarters or years later. Signature Asset Management's, the portfolio manager of the Fund, view is that lower yields will serve as a stabilizing force to growth rather than a precipitator of a deflationary contraction, which is the prevailing bond market view.

Globally, the outcome of Brexit and U.S.-China trade negotiations remain uncertain. In Canada, consumer delinquencies started to rise in late 2018, according to Equifax Canada. Canadians owe $2.168 trillion ($1.55 trillion in residential mortgages and $618 billion in consumer credit), which, as a percentage of gross domestic product equates to 100.2%, a record high for Canada and significantly above the other G7 countries and the G20 (19 advanced industrialized countries and the European Union) average of 58.4%.

On March 25, we attended Scotiabank's annual Retail Real Estate Panel Discussion, featuring Crombie REIT President and CEO Donald Clow, CT REIT President and CEO Ken Silver, Oxford Properties Head of Canadian Real Estate Eric Plesman, RioCan REIT COO Jonathan Gitlin and SmartCentres REIT Chairman Mitchell Goldhar. With one exception (Mr. Plesman), panellists were incrementally more positive on the outlook for Canadian retail fundamentals today versus this time last year. During the discussion, Mr. Goldhar noted retailers are reacting to last-mile delivery by making at- or in-store pickup as seamless and convenient as possible, while Mr. Silver noted certain tenants are seeking more space (not less!) to accommodate e-commerce distribution. Mr. Plesman noted that Oxford Properties is keen to emphasize food and beverages ("F&B") within its retail properties, and the company is targeting 20% of gross leasable area (GLA) versus F&B at 9-10% of GLA today – with a view to increase customer dwell time and, ideally, cross-shopping. Interestingly, Mr. Clow noted Crombie has recently appraised its air rights (i.e., the unused space above its buildings) and is evaluating ways to disclose this value publicly, which we expect will be positive for the company.

In March, Altus Group released its 2019 Canadian Cost Guide, which tracks Canadian real estate development and infrastructure construction costs. The data is based on 3,300 real projects, totalling $210 billion and 773 million square feet. The report noted trade disputes, tariffs, interest rates and a shortage of contractors and skilled labour as factors that make assessing a development project's construction costs increasingly difficult. As many REITs take on greater development risk (e.g., retail REITs increasingly seeking to capitalize on mixed-use development opportunities), we're encouraged that many REITs are partnering with experienced developers, which, in our view, mitigates risk.

On April 1, CBRE Group released its first-quarter 2019 Quarter Statistics report. Demand for industrial space has now outpaced supply for the 11th consecutive quarter, which has driven the national availability rate down in the first quarter of 2019 to a new historical low of 3.0%, down 20 bps sequentially and down a whopping 110 bps year-over-year. The national average net asking rent reached a record high of $7.97 per square foot in the quarter, marking a 12.4% increase year-over-year, led by strong rental rate growth in Toronto, Edmonton and Vancouver. Following a record 31.6 million square feet of positive net absorption in calendar 2018, the first quarter of 2019 saw the net take-up of a further 6 million square feet of industrial space. The unprecedented level of demand is being fuelled by warehousing, transportation and logistics firms expanding their distribution networks across Canada. There is currently 22.6 million square feet (1.2% of existing net rentable area) of much-needed industrial space under construction in Canada, with ~64% concentrated in Toronto (1.2% of existing net rentable area) and Vancouver (2.6% of existing net rentable area).

Similarly, the Canadian office market has continued to tighten, with the national office vacancy rate decreasing 40 bps sequentially to 11.5% in the quarter. Similar to the previous quarter, a strengthening suburban market led the charge, with six of 10 major markets reporting vacancy rate declines of 60 bps or more. While overall vacancy rates remained elevated in downtown Calgary (26.5%) and Edmonton (18.4%) during the first quarter of 2019, the amount of sublet space on the market has returned to pre-oil recession levels, which is incrementally positive for landlords in those two local markets. Downtown Toronto and Vancouver remain extremely tight, with overall vacancy rates of 2.6% and 2.7%, respectively, and Vancouver's office vacancy rate is expected to tighten further through 2019.

News and Noteworthy

- On March 25, RioCan REIT (TSX:REI.UN) announced that Chief Executive Officer Edward Sonshine will remain as CEO until his retirement on March 31, 2021, subject to a potential one-year extension. Upon his retirement, Mr. Sonshine will become the Non-Executive Chairman of the Board of Directors, at which time the current board chairman will become Lead Trustee. The news represents another step in the orderly succession of leadership at RioCan.
- On March 27, Canadian Apartment Properties REIT (TSX:CAR.UN) announced that Mark Kenney has been appointed CEO, which we strongly support.
- On March 29, Canadian Apartment Properties REIT (CAPREIT) and European Residential REIT (ERE) (formerly European Commercial REIT, TSX-V:ERE.UN) announced the closing of the $634-million acquisition of 41 multi-residential properties located in the Netherlands by ERE from CAPREIT. The purchase price was satisfied through the issuance of 81,641,210 Class B units of ERE at $4 per unit (which are convertible one-for-one into trust units of ERE) and through ERE's assumption of ~$307 million of mortgages. CAPREIT is ERE's largest unitholder, with ~83% economic ownership, and will continue to manage the assets pursuant to long-term asset and property management agreements.
- On April 1, Pure Multi-Family REIT (TSXV:RUF.UN) announced it has received conditional approval to list on the Toronto Stock Exchange (TSX). In our view, the TSX listing is positive as it is anticipated to improve liquidity and visibility with investors.

Market Outlook

Despite the rebound from late-2018 lows, REITs have continued to trade at a discount to NAV. With bond yields moderating and the U.S. Federal Reserve seemingly "on hold" amid widespread expectation that economic growth is slowing, we believe real estate will remain a desired asset class. In this environment, we continue to view REITs with mid-single-digit free cash flow yields and mid-to-high single-digit free cash flow growth profiles as attractive. We remain biased toward REIT issuers with low leverage, prudent and sustainable payout ratios, low capital expenditure requirements and strong supply/demand dynamics. Our sector stance continues to favour multifamily, industrial, seniors housing and defensive daily necessity-oriented retail.

Manager's commentary provided by Signature Global Asset Management, the portfolio manager of the First Asset Canadian REIT ETF.

SIGNATURE
GLOBAL ASSET MANAGEMENT™

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Signature Global Asset Management.
Mr. Goldman manages the:
First Asset Canadian Convertible Bond Fund
First Asset REIT Income Fund
First Asset Canadian REIT ETF
First Asset Canadian Convertible Bond ETF
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First Asset REIT Income Fund
Sentry Global REIT Class
Sentry Global REIT Fund

Performance (%)

	1 Month	3 Month	6 Month	YTD	1 Year	2 Year	3 Year	5 Year	10 Year	SI*
First Asset Canadian REIT ETF	**3.22%**	**14.56%**	**10.32%**	**14.56%**	**18.97%**	**12.18%**	**13.39%**	**12.72%**	**16.34%**	**11.26%**
S&P/TSX Composite Index	1.01%	13.29%	1.84%	13.29%	8.11%	4.87%	9.27%	5.44%	9.49%	7.15%
S&P/TSX Capped REIT Index	3.81%	15.77%	12.08%	15.77%	21.46%	14.22%	12.86%	9.61%	16.67%	10.39%
MSCI US REIT Index (Net Return) (USD)	3.14%	15.92%	7.75%	15.92%	19.16%	6.06%	4.65%	7.62%	17.02%	–

Sources: Morningstar Direct and First Asset, as at March 31, 2019. *Inception date is November 14, 2004.

The indicated rates of return are the historical annual compounded total returns, including changes in unit value, and do not take into account sales, redemption or optional charges or income taxes payable by a security holder that would have reduced returns. Performance is calculated net of fees.

*The Fund was originally launched as a TSX-listed closed-end fund on November 15, 2004, and converted into an exchange-traded fund on July 14, 2015. Performance shown is since inception of the closed-end fund. In connection with the conversion, and pursuant to unitholder approval, the annual management fee payable by the Fund to First Asset, as manager, was reduced to 0.75% (from 1.05%) of the NAV per unit and certain changes were made to the investment objectives, strategies and restrictions applicable to the Fund. Material among these changes is the ability for the Fund to invest up to 30% of its portfolio in securities of real estate issuers listed on non-Canadian stock exchanges and the Fund will no longer be permitted to use leverage. Had these changes been in effect prior to this date the performance of the Fund could have been different.

Use of Benchmarks:

The S&P/TSX Capped REIT Index is a capitalization-weighted index designed to measure market activity of the real estate sector issuers listed on the Toronto Stock Exchange. The Index is used as a benchmark to help you understand the Funds performance relative to the general performance of the broader Canadian real estate sector.

The S&P/TSX Composite index is a capitalization-weighted index designed to measure market activity of stocks listed on the Toronto Stock Exchange. This index is used as a benchmark to help you understand the Funds performance relative to the general performance of broader Canadian equity market.

The MSCI US REIT Index (USD) is a market capitalization-weighted index that captures the large, mid and small cap segments of the U.S. real estate equity universe. The index is used as a benchmark to help you understand the Fund's performance relative to the general performance of the U.S. real estate sector.

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