September 17, 2021

U.S. real estate can offer investors a balanced blend of benefits

In a world searching for yield opportunities, we believe that more investors are coming to appreciate the balanced mix of favorable characteristics that U.S. real estate can add to a diversified investment portfolio. In addition to sustainable income, the world's largest commercial real estate market[1] may also offer investors an attractive combination of resiliency and value.

Real estate can offer stable income plus capital appreciation potential

Sitting on the risk/return spectrum between bonds and stocks, private real estate has traditionally attracted investors for its combination of portfolio-enhancing qualities. Today, with global yields across mainstream asset markets near all-time lows, investors are not only taking notice of real estate's capital appreciation potential but also of its history of generating sustainable income. In fact, over the last 10 years, core U.S. real estate has provided an average annual total return of almost 10% with income accounting for almost one-half of that.[2]

Core U.S. real estate can be an income generator

	1 year	**3 years**	**5 years**	**10 years**
Income	3.89%	4.04%	4.16%	4.62%
Capital appreciation	4.01%	1.44%	2.33%	4.80%
Total return	**8.02%**	**5.52%**	**6.57%**	**9.60%**

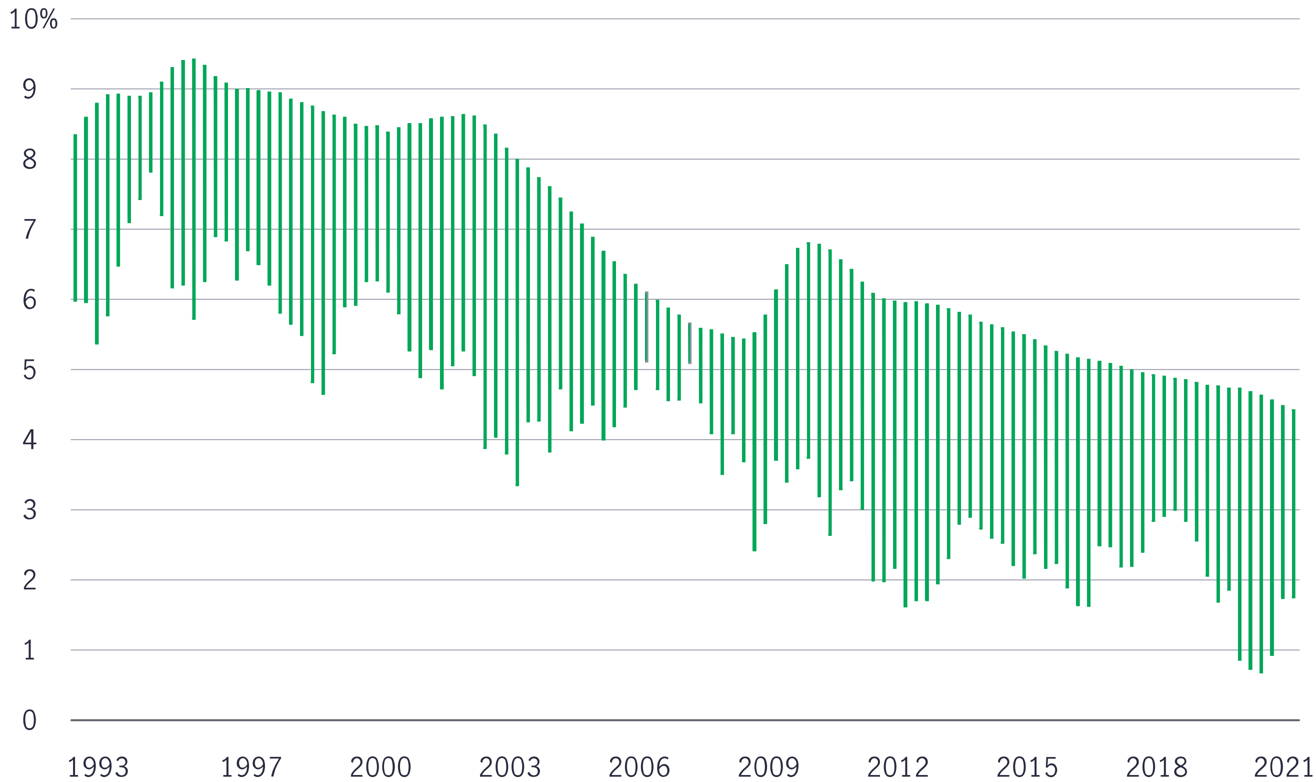
Note: Income is generated through rent collection from owned properties. After accounting for various operating expenses and financing costs, this income gets passed to investors. Capital appreciation is the result of increasing property values through renovations, passage of time, The NFI-ODCE is an index of investment returns reporting on both a historical and current basis the results of 38 open-end commingled funds pursuing a core investment strategy, some of which have performance histories dating back to the 1970s. The NFI-ODCE Index is capitalization weighted and is reported gross of fees.[2] It is not possible to invest directly in an index.

Cap rates point to favorable market conditions

To gauge current real estate market conditions, investors typically look at the market capitalization rate, or cap rate, spread. It's the incremental difference between a building's cap rate—the expected rate of return from an investment based on how much income it's expected to generate—and the yield on a 10-year U.S. Treasury note. The cap rate spread shows the premium investors may expect to earn over the risk-free rate in exchange for bearing the risk of investing in commercial real estate.

The cap rate spread is also an indicator of the real estate market's appreciation potential. Generally, high spreads indicate there's room for spread compression and, by extension, for property prices to appreciate. As cap rate spreads narrow, property prices are likely to increase, all else being equal. By contrast, low spreads can point to greater potential for spread widening and property prices falling. Near the market peak before the global financial crisis, the U.S. commercial real estate cap rate spread narrowed to a low of 0.57%, before quickly widening in 2008/2009 as property prices fell.[3]

U.S. commercial real estate cap rate spread over the 10-year government U.S. Treasury bond yield



Source: NCREIF Property index, Federal Reserve Economic Data, as of Q2 2021.

Today, the U.S. commercial real estate cap rate spread is indicating a favorable prospective return environment with a spread of 267 basis points over the 10-year Treasury note.[4]

Real estate can offer other significant portfolio benefits

Not only can real estate offer stable income generation and appreciation potential, in our view, it also has a history of complementing mainstream assets with the potential to introduce diversification benefits, inflation hedging attributes, and resiliency into investor portfolios.

1. Potential diversification benefits through low correlation with other asset classes

During periods of market volatility, we believe private real estate can counterbalance mainstream financial assets by offering diversification benefits. With a low correlation to equity and debt markets, private real estate may lower portfolio risk, or price volatility, relative to expected returns.[5]

Real estate has lower correlation to other asset classes

	U.S. private real estate	**S&P 500 Index**	**U.S. IG bonds**	**Public real estate**
U.S. private real estate	**1.00**			
S&P 500 Index	**0.15**	1.00		
U.S. IG bonds	**-0.08**	-0.31	1.00	
Public real estate	**0.21**	0.62	0.02	1.00

Source: NCREIF Property Index, Bloomberg, based on quarterly data between 1/1/97 and 6/30/21. The NCREIF Property Index is the source for U.S. private real estate, FTSE NAREIT All Equity REIT Index is the source for public real estate, and the Barclays U.S. Aggregate Bond Index is the source for U.S. investment-grade (IG) bonds.

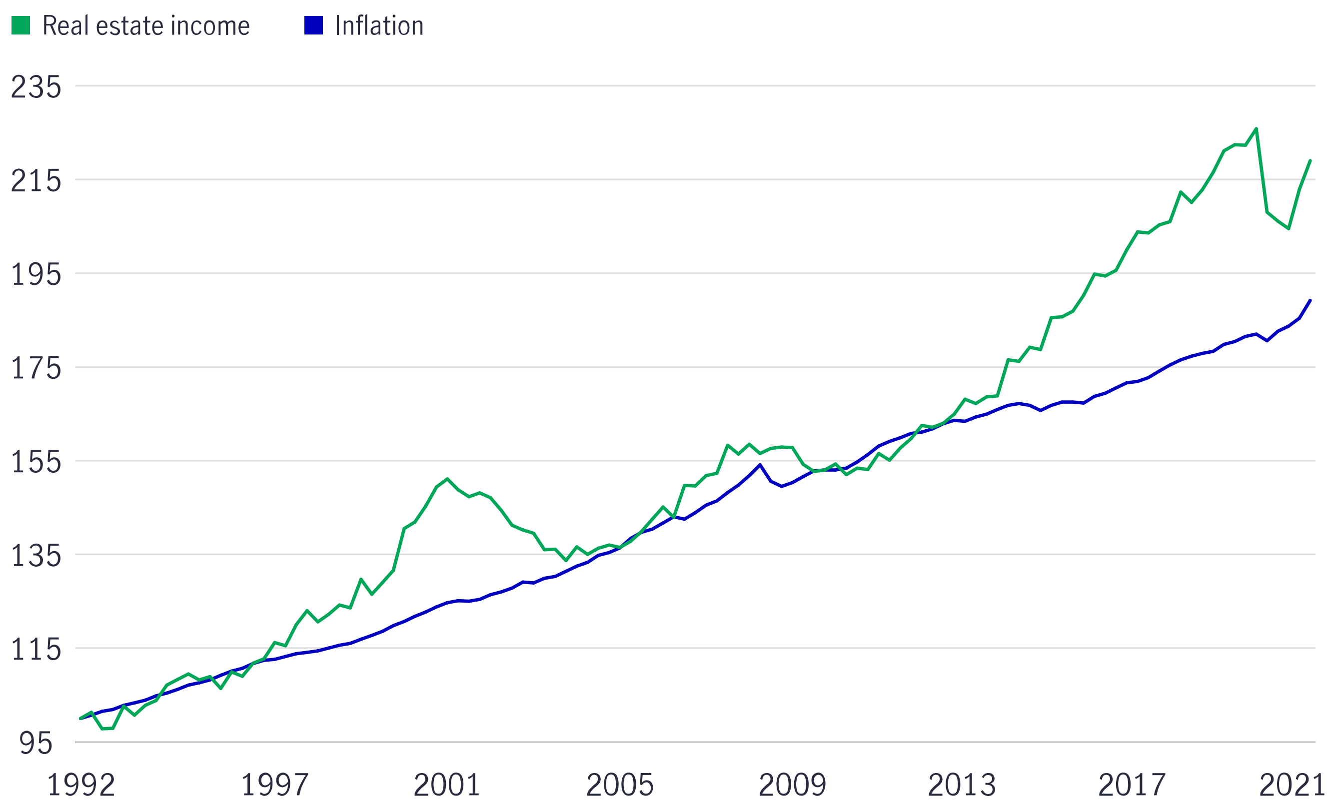
Whereas public markets quickly reprice new information, U.S. private real estate is more tempered in its reaction to investor sentiment. With a longer-term investment horizon, multi-year lease agreements, and periodic valuation process, this asset class has historically provided a smoother return profile with less day-to-day price volatility.

2. Potential inflation hedge

Another distinguishing feature of private real estate relative to other asset classes is its potential inflation hedging characteristics. Unlike nominal bonds that only compensate investors for inflation expectations at the time of purchase, real estate leases and property values typically increase along with inflation. In fact, over the last 28 years, real estate income has slightly outpaced the average annual rate of inflation—2.7% versus 2.2%.[6] We believe this quality potentially reduces the risk of inflation eroding investment value—a risk commonly associated with bonds.

Property income growth has kept up with inflation

Index level, Q4 1992=100



Source: NCREIF Property Index, U.S. Bureau of Labor Statistics, based on quarterly data between 10/1/92 and 6/30/21. The NCREIF Property Index is the source for real estate income based on net operating income growth. The Consumer Price Index for all urban consumers is the source for inflation.

3. Downside portfolio protection amid public market volatility

In the face of uncertainty, history suggests that sizable market drawdowns occur at regular intervals. Attempting to market time these drawdowns has repeatedly proven futile, but we believe that strategic asset allocation can help insulate portfolios from unexpected market events by reducing drawdown risk and alleviating the consequences of negative effects on wealth creation. An analysis that looks at maximum drawdown during significant market events over the last 30 years shows that private real estate has shown more resiliency compared to equities throughout this time.

Maximum drawdown during significant market events

	Early 1990s recession	1998 financial crisis	Dot-com bubble	Global financial crisis
S&P 500 Index total return	-13.70%	-6.80%	-26.10%	-44.50%
NCREIF Property Index return	**-1.40%**	**3.46%**	**0.67%**	**-23.90%**

Source: Bloomberg, NCREIF Property index based on quarterly data between 1/1/90 and 12/31/20.
It is not possible to invest directly in an index.

What are the different types of real estate strategies?

With investors considering leaning further into this alternative asset class for exposure to a balanced blend of benefits, it's vital to distinguish between the strategies offered on the market today. While many can provide income, the risk/return spectrum is heavily dependent on market exposure and the use of leverage in each strategy. While the industry typically categorizes real estate into four main strategies, there isn't a standard definition across all firms. We offer a general guideline.

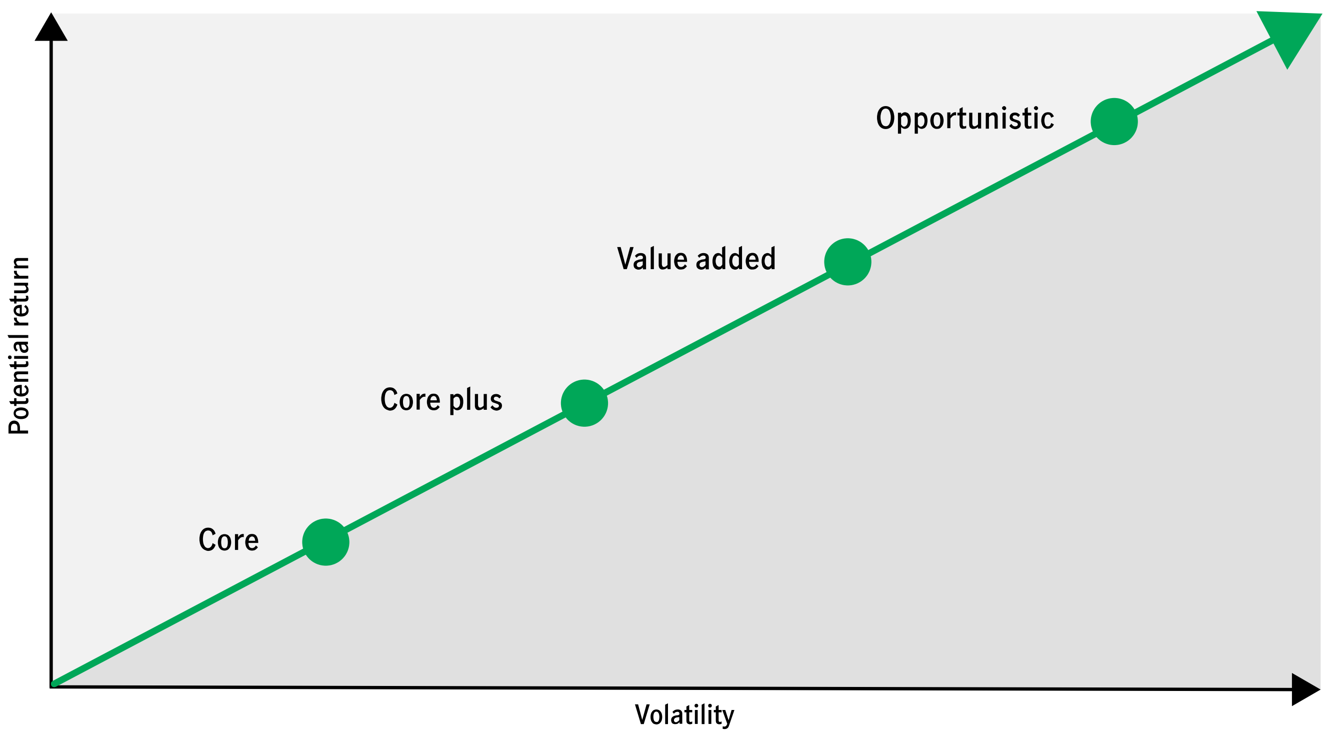
Four main commercial real estate strategies in the market

Core	• This lower risk strategy focuses on income generation by investing in high-quality core assets that have high occupancy rates with high-quality tenants locked into long-term leases. • The majority of expected return is likely to be generated through cash flow from owned properties.
Core plus	• This strategy combines core assets and core-plus assets to create a balanced mix of risk and return. • Core-plus assets, like core assets, generate income but their cash flow potential can be increased through minor property enhancements, attracting higher quality tenants, or better property management efficiencies. • Once cash flow has been increased, the core-plus asset is often sold to capture the appreciation value.
Value added	• This strategy invests in properties that have the potential to produce significant cash flow after value has been added. • While the total return potential is high, these properties require renovation, a long investment time horizon, and come with greater risk due to increased leverage.

Opportunistic	• This strategy follows a value-added approach but further up the risk spectrum. • These highly distressed properties require major renovation or development of raw land and are financed with very high levels of leverage, which offer higher return opportunities.

Source: Manulife Investment Management, 2021. This is provided for illustrative purposes only and depicts the general risk/return profile of real estate investment styles. It can be expected that actual risk and return may vary from those shown.

Potential risk/reward characteristics of commercial real estate strategies



Source: Manulife Investment Management, 2021. This is provided for illustrative purposes only and depicts the general risk/return profile of real estate investment styles. It can be expected that actual risk and return may vary from those shown.

In a yield-starved world, stable income-generating strategies are in the spotlight

For those specifically looking for stable income generation, investors may consider leaning into core and core-plus private U.S. real estate strategies. These asset portfolios, which are generally made up of Class A properties located in well-diversified primary markets across the United States, are typically well occupied with long-term leases in place. With a focus on attaining credit-worthy tenants who can better withstand economic challenges, these strategies may generate resilient cash flow from lease and rent collection.

Core and core-plus private real estate strategies capitalize on income-growing opportunities by investing in properties that reflect the evolving needs of businesses, consumers, and occupiers. By using less leverage relative to value-added and opportunistic strategies, they typically exhibit lower risk and volatility of returns. While total return potential may be lower, it can create more opportunities for stable income generation—a key goal of core and core-plus strategies.

Consider the risks involved

Although investing in real estate may offer numerous benefits, investors should also consider the inherent risks involved. While not all risks can be recognized ahead of time, those that can be identified are managed or minimized through diversification, active management, and other strategies.

Risk		Potential mitigation techniques
Business	Demand for real	Portfolio

conditions	estate depends on a variety of economic conditions, including GDP, interest rates, inflation, and employment.	diversification and active management.
Demographics	Demand for real estate depends on a variety of factors, including size and age of the local population and rate of new household formations.	Diversification across markets, property sectors, and tenants.
Liquidity	Real estate is considered illiquid due to the lack of ability to convert investments quickly into cash without a significant impact on price.	Active management and disciplined risk management process.
Leverage	Leverage can affect returns as funds for projects are often borrowed. Changes in interest rates and the ability to service loans are key things to consider.	Active management and disciplined risk management process.

Environmental	Real estate can be affected by environmental conditions, such as hurricanes, wildfires, and floods.	Diversification and purchase of insurance protection.
Property management	The risk lies in a property manager's ability to oversee day-to-day operations, service tenants, reduce turnover, and create operating efficiencies.	Disciplined risk management process.

Note: no investment strategy or risk management technique can eliminate risk or guarantee returns in any market environment.

Real estate can offer an attractive mix of portfolio benefits

As the global economy continues to recover, surveys indicate that capital is expected to continue to flow into this asset class as investors continue to search for opportunities.[7] With more attention focused on the attractiveness of U.S. income-oriented private real estate strategies, this hybrid asset class combines the potential benefits of bond and equity markets. Not only can private real estate offer portfolio diversification benefits, it can also offer value and income—qualities that we believe are becoming increasingly harder to find these days.

1 Real estate market size 2019/2020, MSCI, 2019. **2** NFI-ODCE Fund Index, as of Q2 2021. **3** NCREIF Property index, Federal Reserve Economic Data, as of Q2 2021.
4 Bloomberg, Federal Reserve Economic Data, based on quarterly data between 1/1/97

and 6/30/21. **5** NCREIF Property Index, Bloomberg, based on quarterly data between 1/1/97 and 6/30/21. **6** NCREIF Property Index, U.S. Bureau of Labor Statistics, based on quarterly data between 10/1/92 and 6/30/21. **7** Americas Investor Intention Survey, CBRE, March 2021.

Important disclosures

A widespread health crisis such as a global pandemic could cause substantial market volatility, exchange-trading suspensions and closures, and affect portfolio performance. For example, the novel coronavirus disease (COVID-19) has resulted in significant disruptions to global business activity. The impact of a health crisis and other epidemics and pandemics that may arise in the future, could affect the global economy in ways that cannot necessarily be foreseen at the present time. A health crisis may exacerbate other pre-existing political, social and economic risks. Any such impact could adversely affect the portfolio's performance, resulting in losses to your investment.

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