February 2024

REIT Industry Update

Commercial Real Estate Weak Amidst Rates and Recession

Despite being weighed down by the twin worries of recession and inflation, REITs had a solid 2023. REITs were up 14 percent, with the S&P 500® Index up 26 percent and the 10-year Treasury ending up at 3.88 percent.[1] Year-to-date through 1.31.2024, REITs are down -4 percent[2] to start the year, as the market contemplates the timing and magnitude of coming rate cuts.

On the private side of commercial real estate, Green Street Advisors' Commercial Property Price Index has surpassed its prior cycle peak in 2007 by 20 percent.[3] More recently however, values are down 20 percent from its pandemic-induced peak (3.22). Providing support for real estate valuations are capital markets that remain open for quality institutions and properties. Growth in real estate demand has been sufficient to stabilize occupancy levels in the mid-90 percent range.[4] In the current environment, landlords are balancing pricing power with an eye towards any potential weakness from a recession or pullback.

Commercial Real Estate and the FED

Commercial real estate was a victim during the recent round of rate hikes as the Federal Reserve (Fed) sought to get a handle on an historic inflationary surge. After 11 rate hikes and an economic environment not seen since the 1980s, the Fed is now poised to cut rates. While the markets are trying to divine the timing and pace of cuts, most agree that we've seen the peak in rates.

The coming rate cuts augur a favorable backdrop for REITs, which tend to correlate with interest rates. Examining the prior four rate cycles dating back to the 1990s, a study by NAREIT shows that four quarters following Fed hikes, REITs have performed very well. On average, REITs were up 21 percent during those four quarters compared to 11 percent for private commercial real estate and 17 percent for the S&P 500® Index.[5]

Should that strong REIT stock performance materialize, a related benefit that will potentially further enhance the attractiveness of REITs is external growth. REITs typically are net acquirers, but a frozen transaction market following COVID, led by rapidly increasing debt and equity costs, took away that avenue of growth. However, as the economic backdrop provides better underwriting clarity and investment decision-making, as well as to more attractively priced capital, REITs should be in a favorable position to restart their acquisition engines, boosting earnings growth.

The Case for REITs

During the fourth quarter of 2023 equity REITs delivered a 16 percent total return compared to 12 percent for the S&P 500® Index.[1] Guggenheim Investments LLC feels public real estate offers several benefits for an individual investor's portfolio that are particularly relevant in today's environment:

- REITs may provide attractive current income with the potential for future dividend growth as underlying property cash flows grow over time.
- Real estate provides inflation hedging characteristics as underlying rents, property cash flows, and replacement costs have historically adjusted with inflation over the long run.
- REITs have historically offered low correlation with other stocks and bonds.

1 Bloomberg, 12.30.2023. REITs are represented by the FTSE NAREIT Equity REIT Index. **2** Bloomberg, 1.31.2024. **3** Green Street Advisors, Inc., Commercial Property Price Index, February 2024. **4** Citi Investment Research & Analysis, Weekly REIT and Lodging Strategy, January 18, 2024. **5** NAREIT, "2024 REIT Market Outlook: Recovery Could Be On the Horizon." December 4, 2023.

For information on investment products offering REIT market exposure, please contact your financial advisor or visit GuggenheimInvestments.com.

Index Definitions (Each index is unmanaged and it is not possible to invest directly in any index.) **FTSE NAREIT Equity REIT Index** is a free float-adjusted index of REITs that own, manage, and lease investment-grade commercial real-estate. **S&P 500 Index** is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. **Green Street Commercial Property Price Index** ("CPPI") is a time series of unleveraged U.S. commercial property values. CPPI captures the prices at which commercial real estate transactions are currently being negotiated and contracted.

Risk Considerations Past performance does not guarantee future results. These illustrations are not representative of any Guggenheim Investments product. There are risks associated with investing, including the entire loss of principal you invest. In general, equity securities will fall due to general market and economic conditions, perceptions regarding the industries, or factors relating to specific companies. Focusing on an industry/sector may present more risks than investing in securities that are more broadly diversified over numerous industries and sectors of the economy. Investments in REITs entail risks. REITs may concentrate their investments in specific geographic areas or in specific property types, such as hotels, shopping malls, residential complexes and office buildings. The value of the REIT and the ability of the REIT to distribute income may be adversely affected by several factors, including: rising interest rates; changes in the national, state and local economic climate and real estate conditions; perceptions of prospective tenants about the safety, convenience and attractiveness of the properties; the ability of the owner to provide adequate management, maintenance and insurance; the cost of complying with the Americans with Disabilities Act; increased competition from new properties; the impact of present or future environmental legislation and compliance with environmental laws; changes in real estate taxes and other operating expenses; adverse changes in governmental rules and fiscal policies; adverse changes in zoning laws; declines in the value of real estate; the downturn in the subprime mortgage lending market in the United States; and other factors beyond the control of the issuer of the REIT.