

# Introducing the 11<sup>th</sup> Sector: Real Estate

**August 2016**

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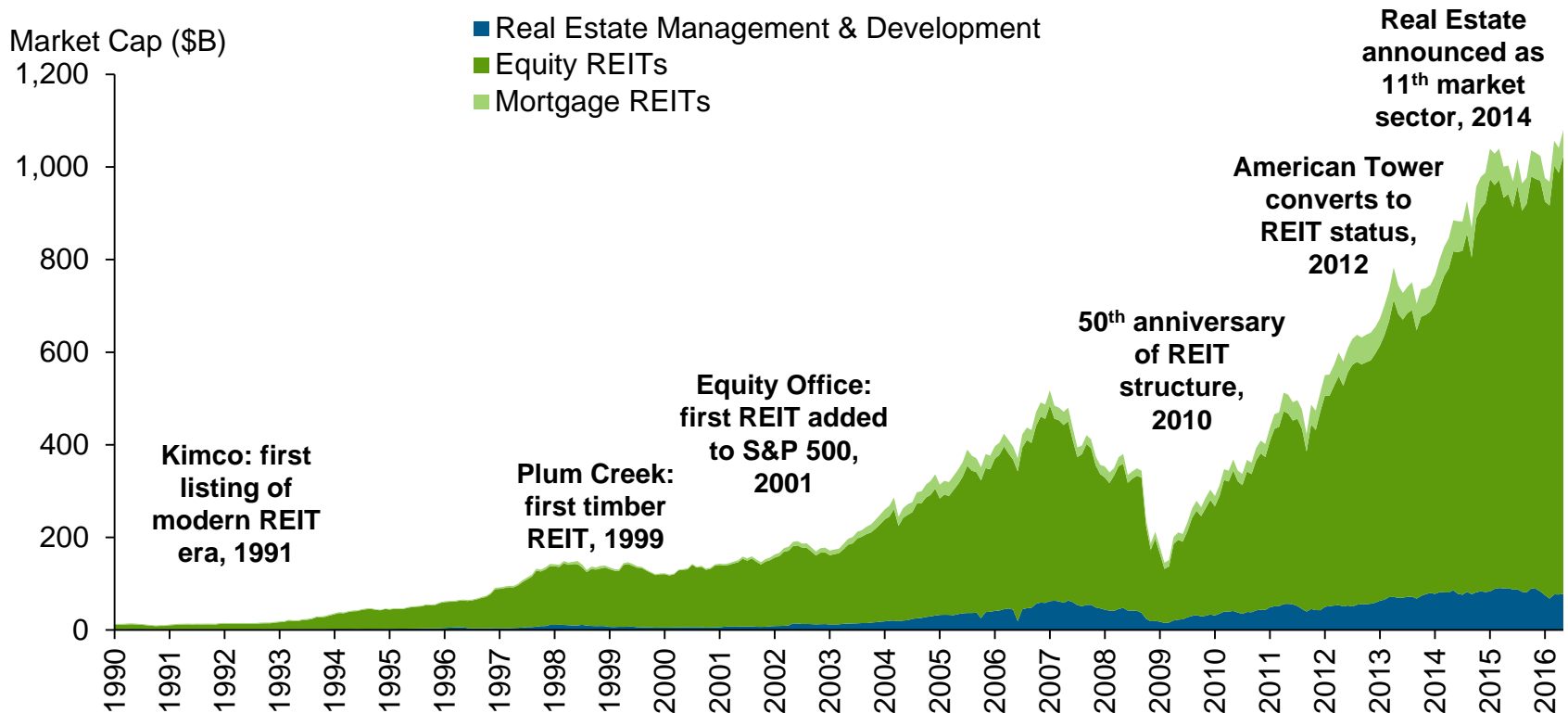


# Evolution of Real Estate as the New 11th Sector



On August 31, real estate will be elevated from an industry within the Global Industry Classification System (GICS) Financials sector to its own individual sector.

## Real Estate Timeline

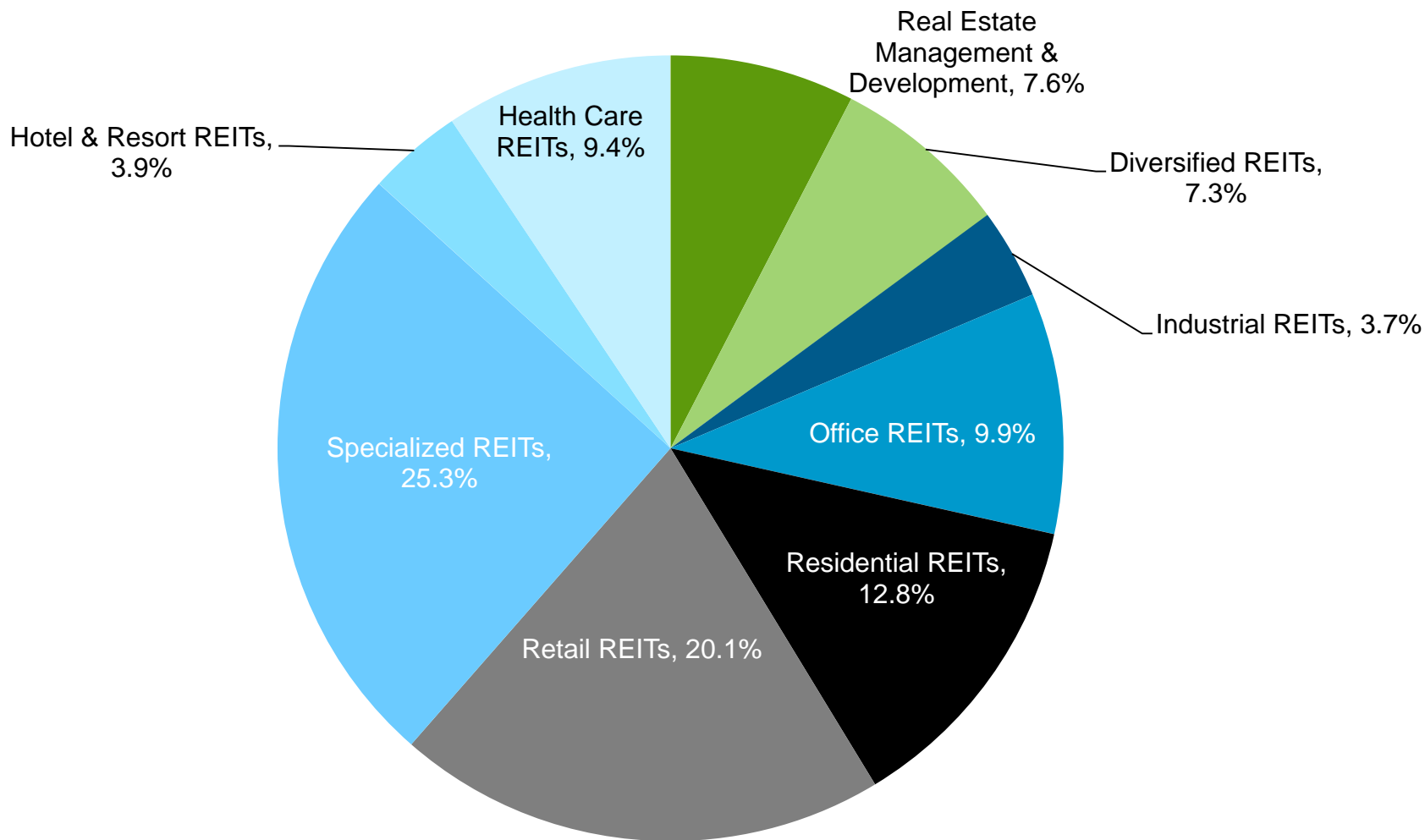


Mortgage REITs will remain in the Financials sector. Source: NAREIT, REIT.com (<https://www.reit.com/investing/reit-basics/reit-industry-timeline>), Haver Analytics, as of May 31, 2016.



# Composition of the New Real Estate Sector

Most of the new sector will be comprised of Real Estate Investment Trusts (REITs)



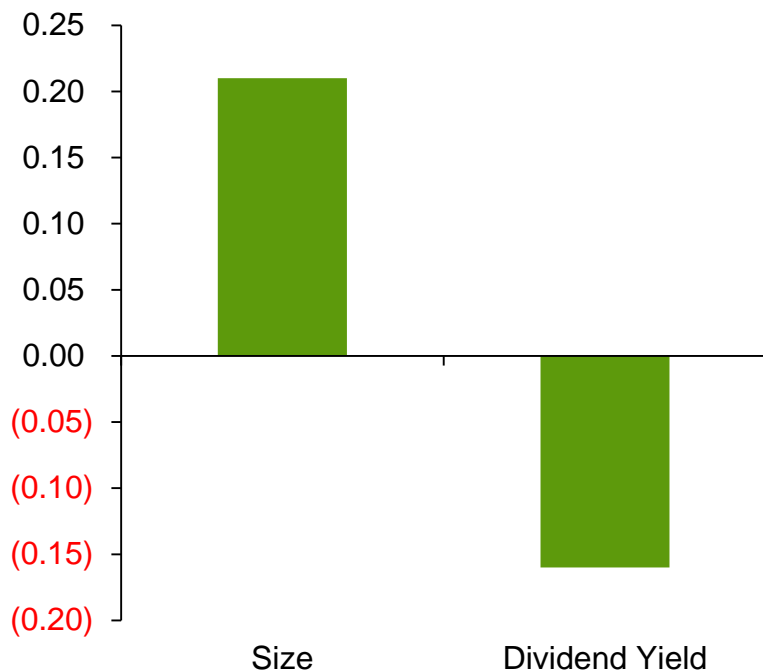
Source: Haver Analytics based on the top 3000 us stocks, as of May 31, 2016. Real Estate Management & Development is an industry, all others shown are sub-industries

# Impact on Financials Sector When Real Estate is Removed



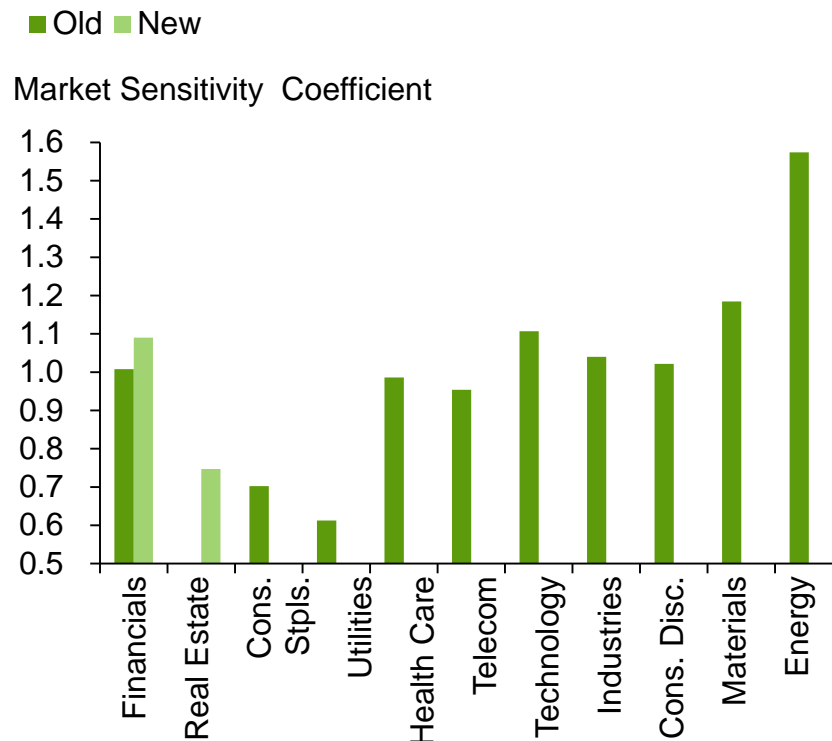
## Financials: Larger Cap, Smaller Dividend

Change in Exposures for Financials ex Real Estate, 5 years ending Apr. 30, 2016



## Real Estate: Relatively Low Market Sensitivity Compared to Most Sectors

Market Sensitivity, 5 years ending Apr. 30, 2016



**Left:** MSCI Barra U.S. Equity Long-Term Model used for size, and dividend yield exposure. Sector characteristics with regard to market cap and dividend yield are not fixed and have changed over time. **Right:** Beta (market sensitivity) is a measure of the covariance of a security (or sector) compared with the broader market, in this case the S&P 500® Index. A beta of more than 1.0 suggests a sector (or security) is more volatile than the market; a beta below 1.0 suggests a sector is less volatile than the market. Sectors represented by the MSCI USA Investable Market Index (IMI) Sector Indexes. Past performance is no guarantee of future results. Sources: MSCI Indexes, MSCI Barra, Fidelity Investments, as of Apr. 30, 2016.



# Why Invest in REITs?



**DIVERSIFICATION:** Low historical correlation with broader market; has offered an attractive risk/return tradeoff

**INCOME:** REIT structure has provided investors with reliable income returns and a yield that has historically exceeded the S&P 500; helps to reduce overall portfolio volatility

**INFLATION PROTECTION:** Historical returns have outpaced inflation; natural hedge during periods of high or low inflation

**PERFORMANCE:** REITs have historically outperformed other major asset classes over long-term; total returns are driven by a combination of capital appreciation and dividend income

**LIQUIDITY:** Daily liquidity through public equity markets; allows for tactical asset allocation and portfolio rebalancing

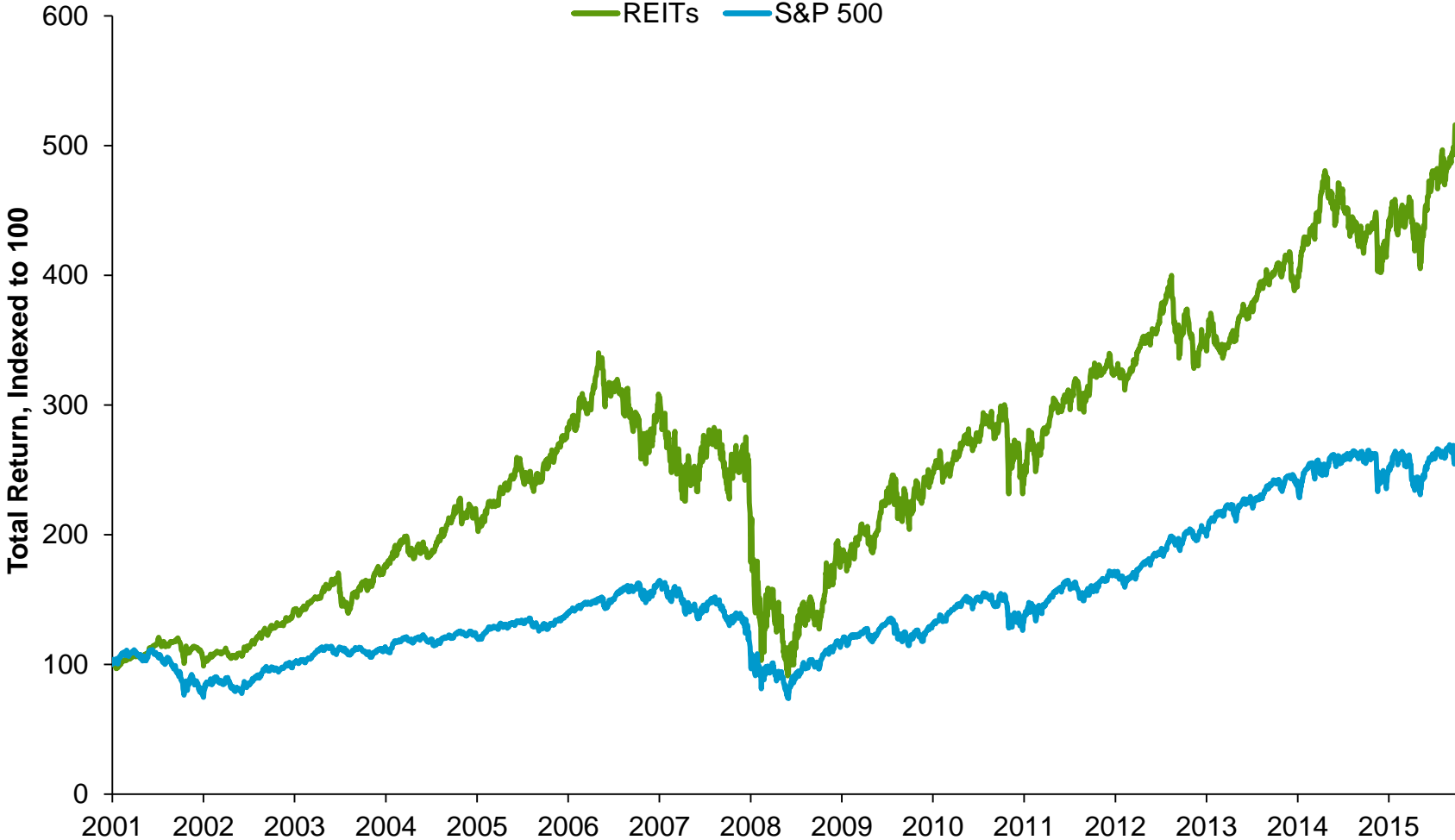
**TRANSPARENCY:** Tax transparency; market transparency; strong corporate governance

Source: National Association of Real Estate Investment Trusts (NAREIT) as of 12/31/2015.

Diversification does not ensure a profit or guarantee against a loss. Past performance is no guarantee of future results.



# Performance of REITs since First REIT Added to S&P 500



Past performance is no guarantee of future results.  
Start = Oct 9, 2001. Source: Fidelity as of 6/30/2016. REIT benchmark: FTSE NAREIT All Equity REITs Index.

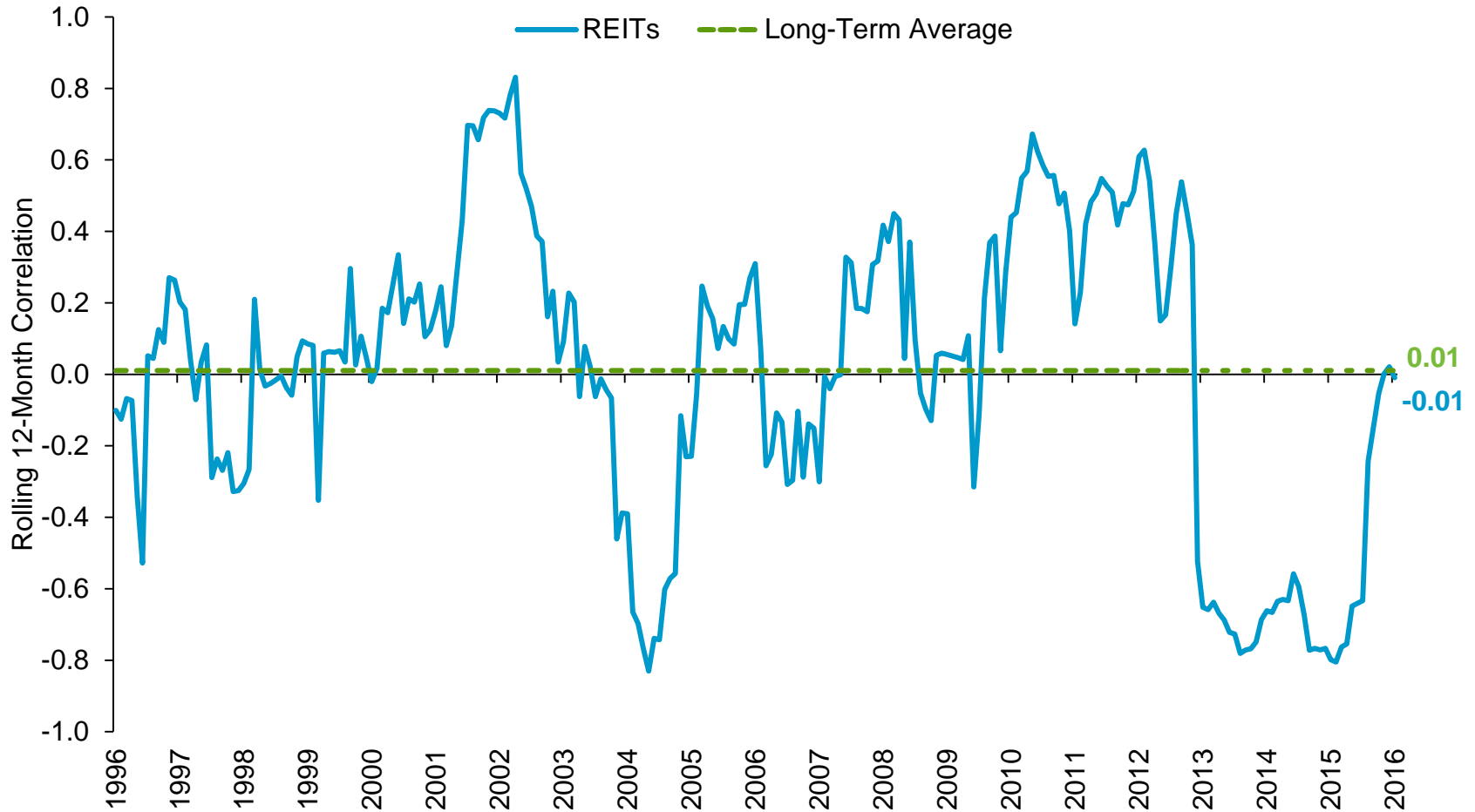


# Interest Rates

REIT performance has demonstrated limited correlation to changes in interest rates over the long term



## REIT Correlation to Changes in 10-year Treasury Bond Yields



Past performance is no guarantee of future results.

Source: Fidelity as of 6/30/2016. REIT benchmark: FTSE NAREIT All Equity REITs Index.

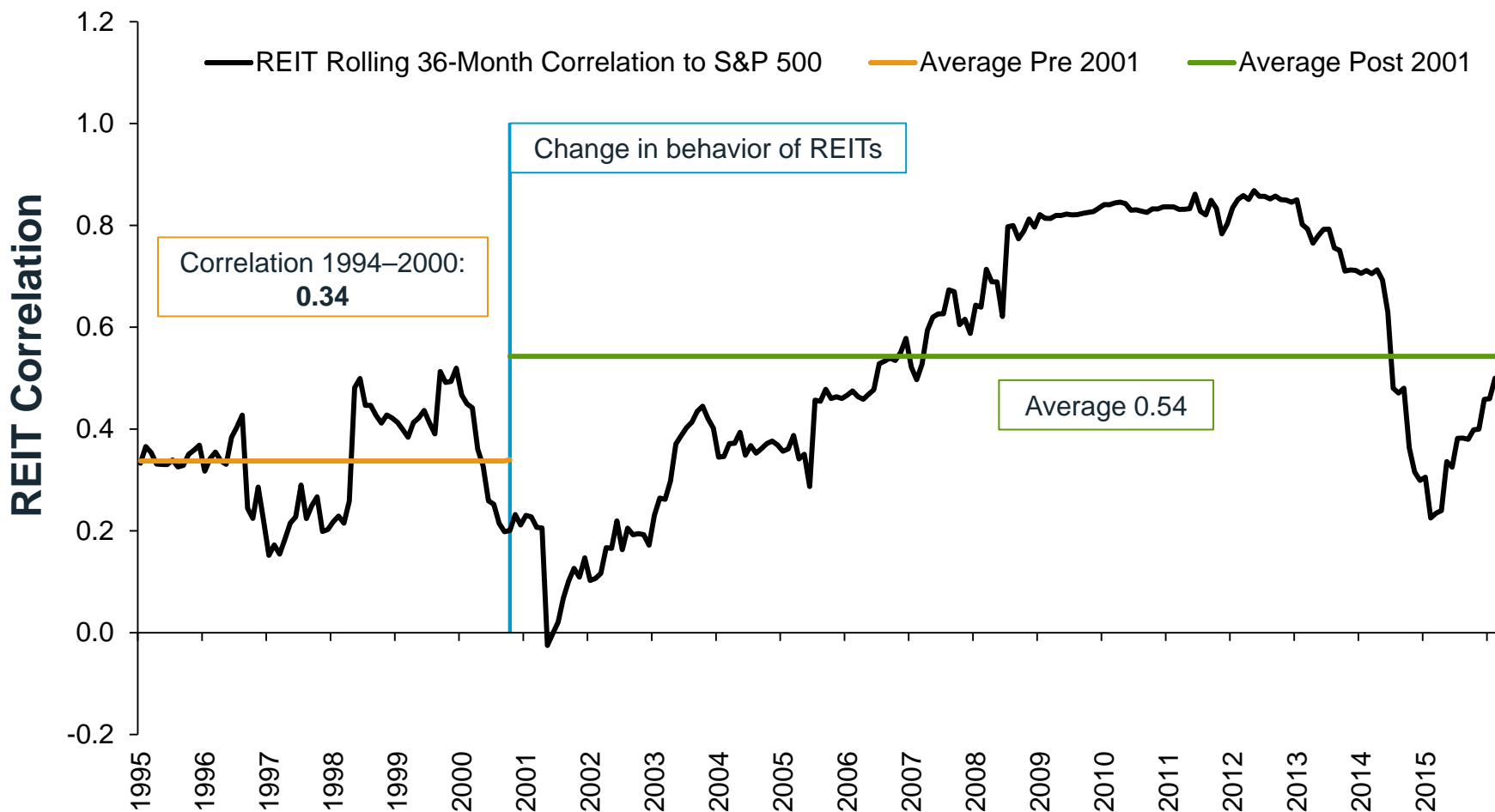


# REIT Correlation to the S&P 500

REIT correlations to the S&P 500 have declined to historical norms from elevated levels, strengthening appeal as a portfolio diversifier



## REIT Correlation To S&P 500 (36 Month Rolling)



Past performance is no guarantee of future results.

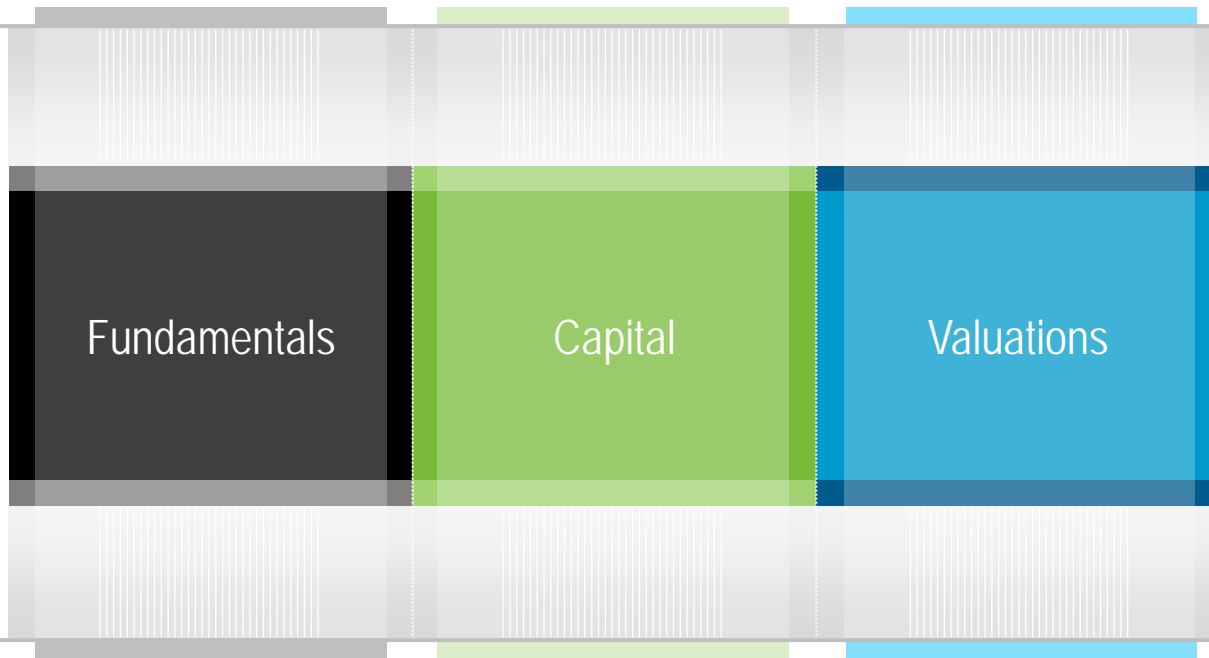
For illustrative purposes only.

Source: Fidelity Investments as of 06/30/2016. S&P 500 and FTSE NAREIT All Equity REITS.





# Market Conditions

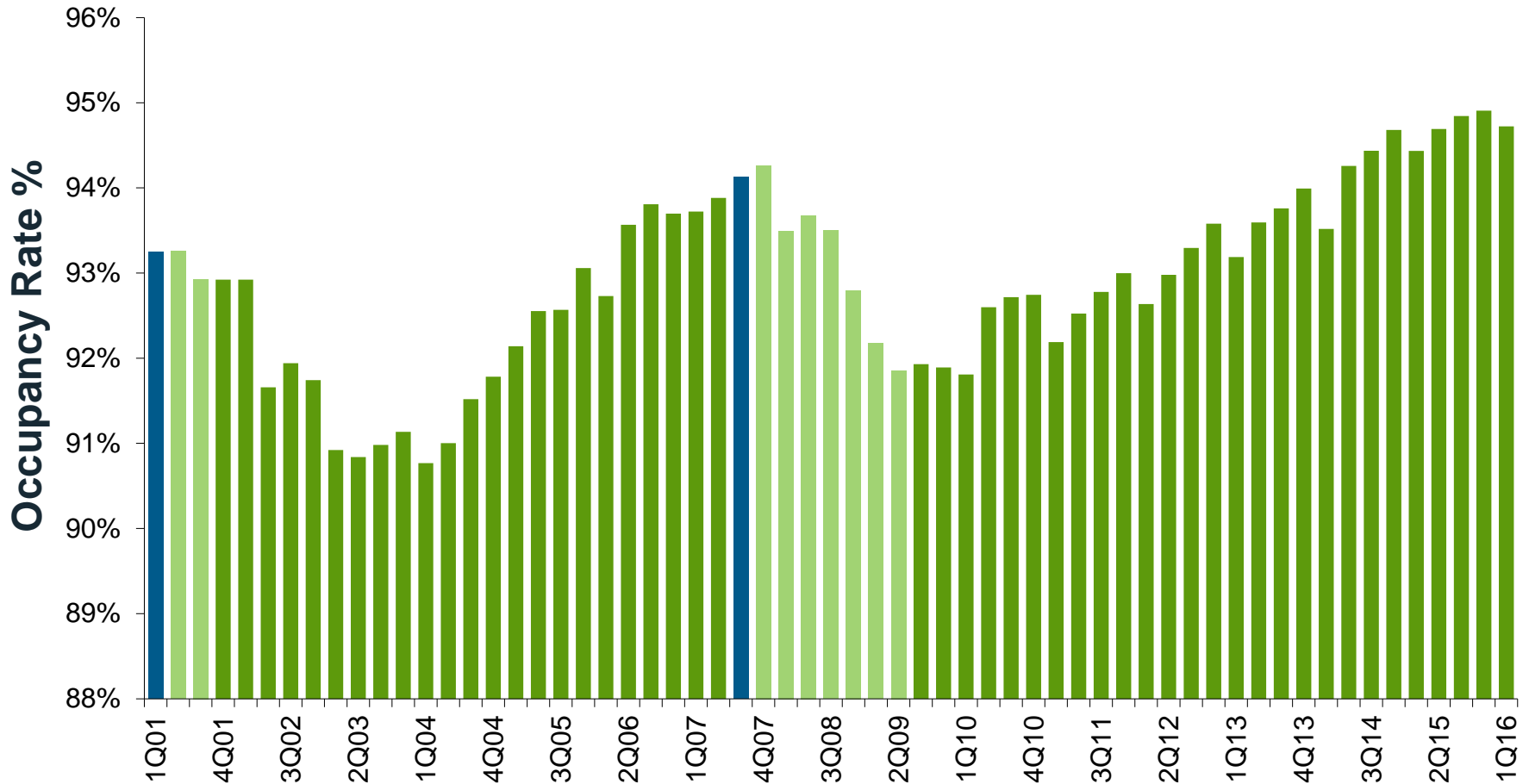


# U.S. Commercial Real Estate Demand

Occupancy continues to improve supported by economic growth and limited new supply



## Occupancy



Source: Citi Investment Research and Analysis as of 03/31/2016.

Note: This time-sequential graph is based on the same-store data.

Green bars show the periods of recession.

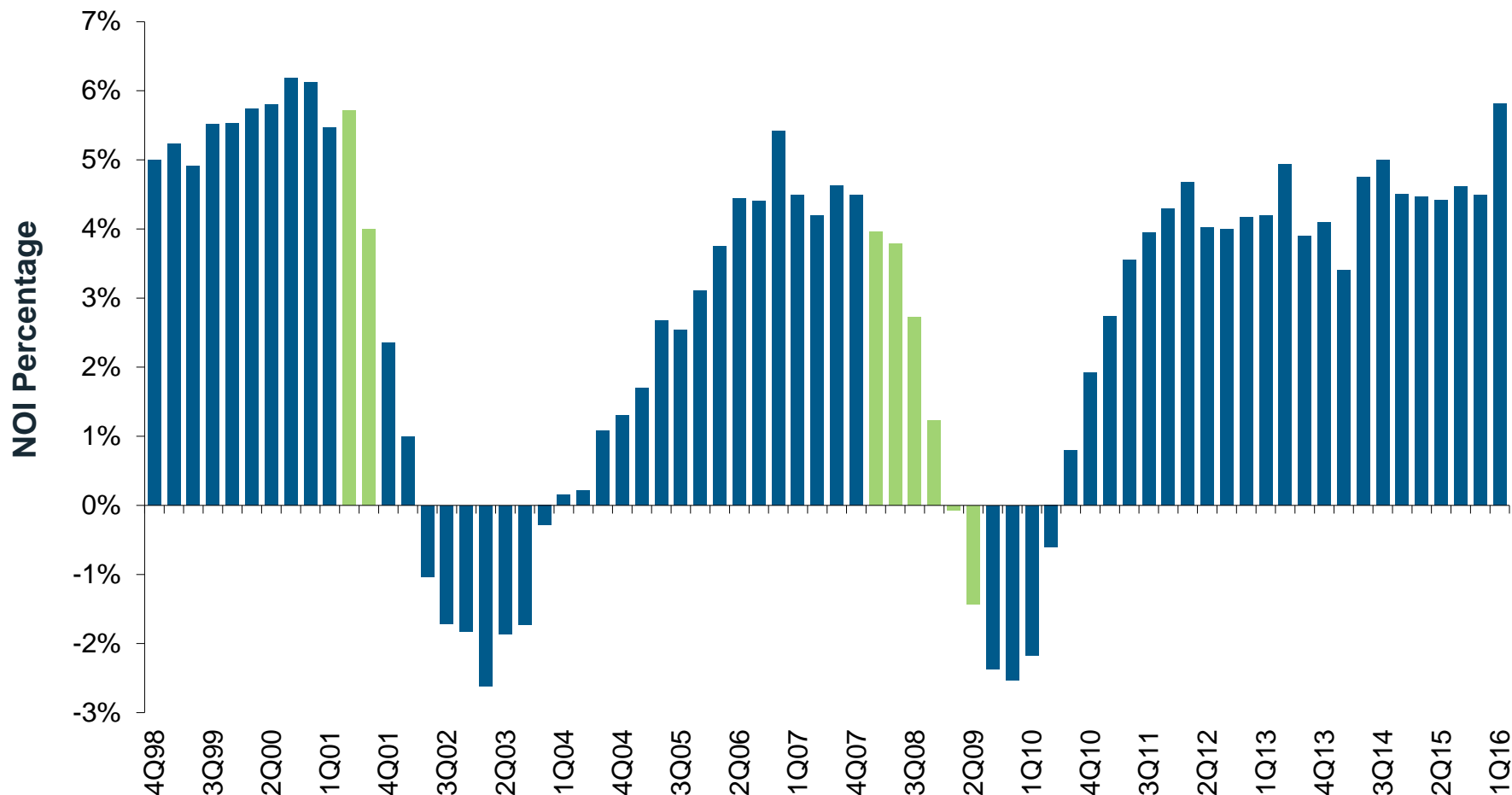


# U.S. Commercial Real Estate Demand

Net Operating Income (NOI) continues to improve, supported by economic growth and limited new supply



## NOI Growth



Source: Citi Investment Research and Analysis as of 03/31/2016.

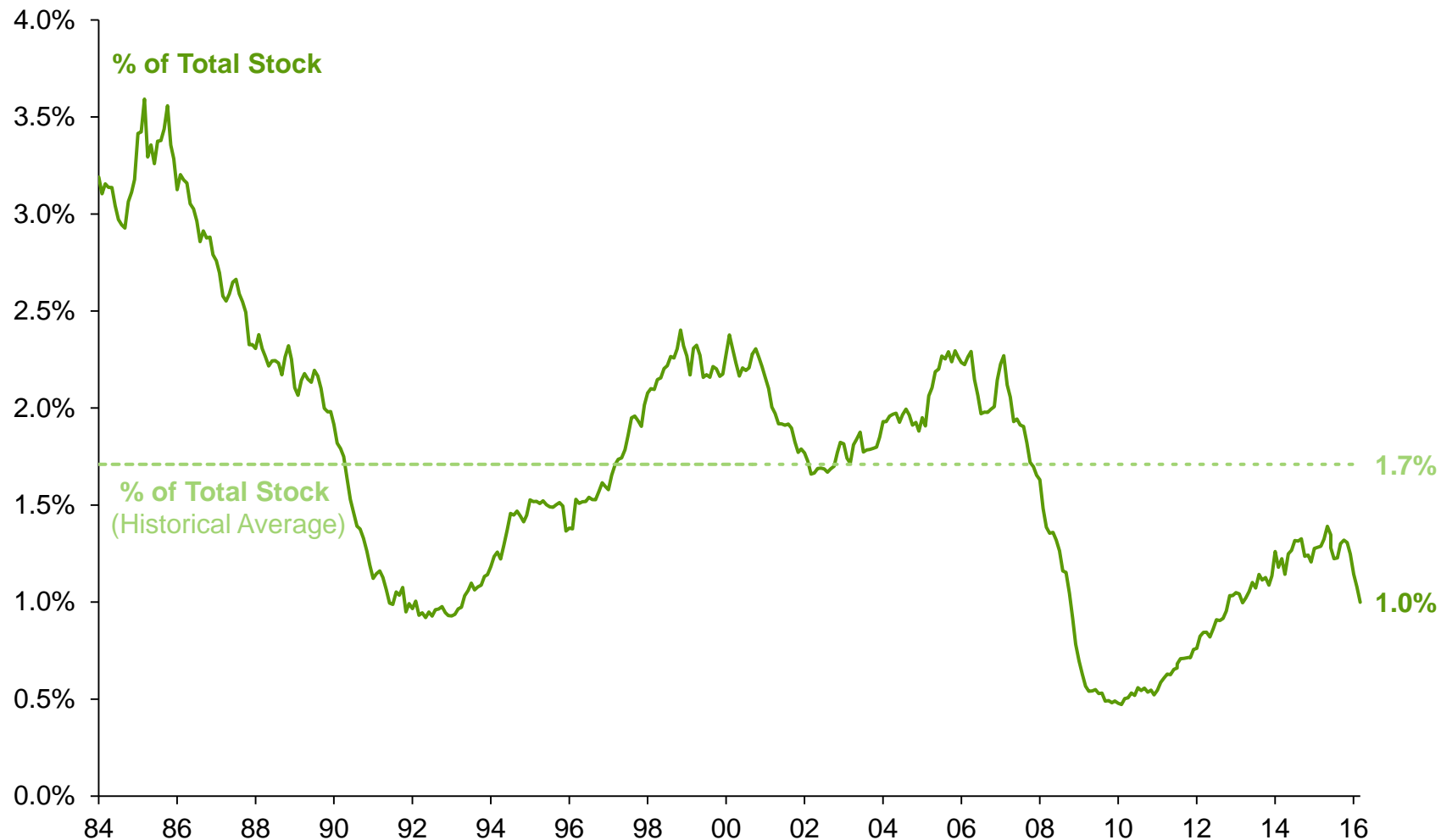
Note: This time-sequential graph is based on the same-store data.

Green bars show the periods of recession.



# U.S. Commercial Real Estate Supply

Despite a recent uptick in deliveries, U.S. commercial real estate supply is still below its historical average



Source: Citi Investment Research and Analysis as of 06/30/2016.

Percent of total stock represents supply addition of U.S. commercial real estate as a percentage of the total U.S. commercial real estate.

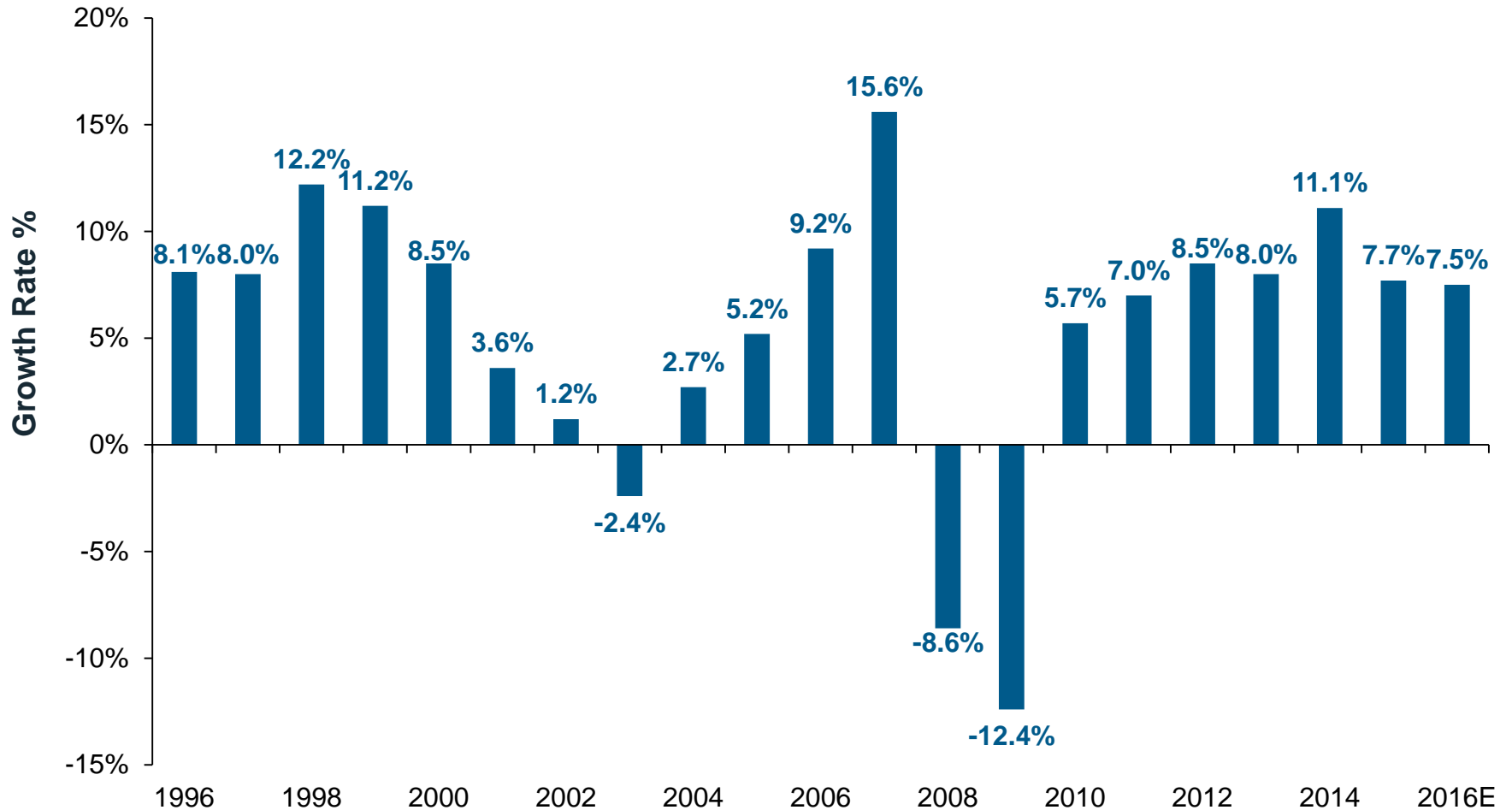


# U.S. Commercial Real Estate Earnings

Average REIT earnings growth is still strong from improving fundamentals and lower debt cost



### REIT Earnings per Share Growth



Earnings represented by funds from operations (FFO).

Source: PPR, Citi, Barclays Capital, and Thompson Financial, Fidelity Investments as of 06/30/2016.

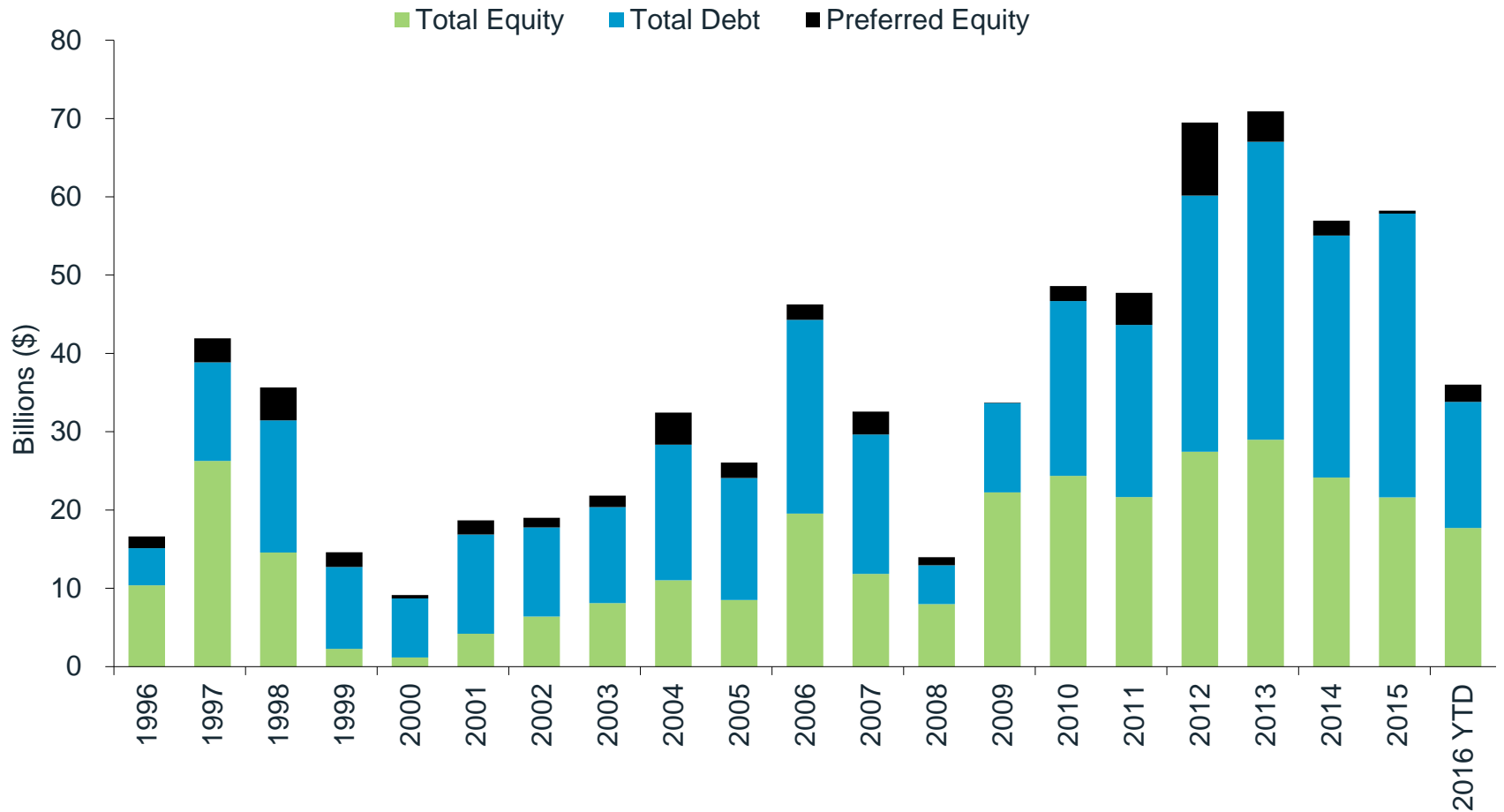


# Capital

Public REITs have access to all forms of capital



## Capital Raised



Source: Citi Investment Research and Analysis as of 06/30/2016.

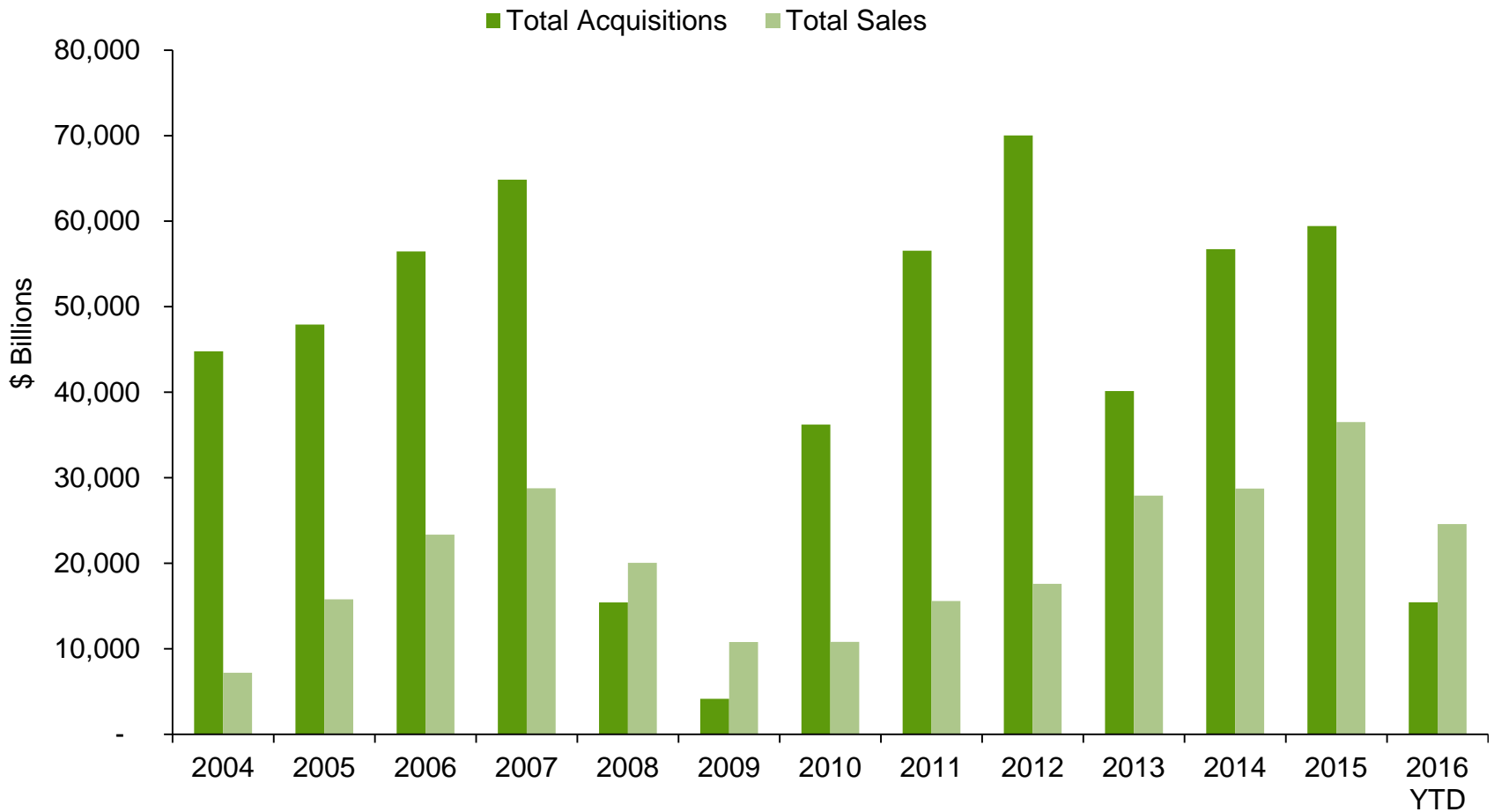


# REIT Acquisitions and Sales

REITs have exploited higher property prices by selectively selling certain assets



## Annual REIT Transaction Volume



Source: Citi Investment Research and Analysis as of 06/30/2016.

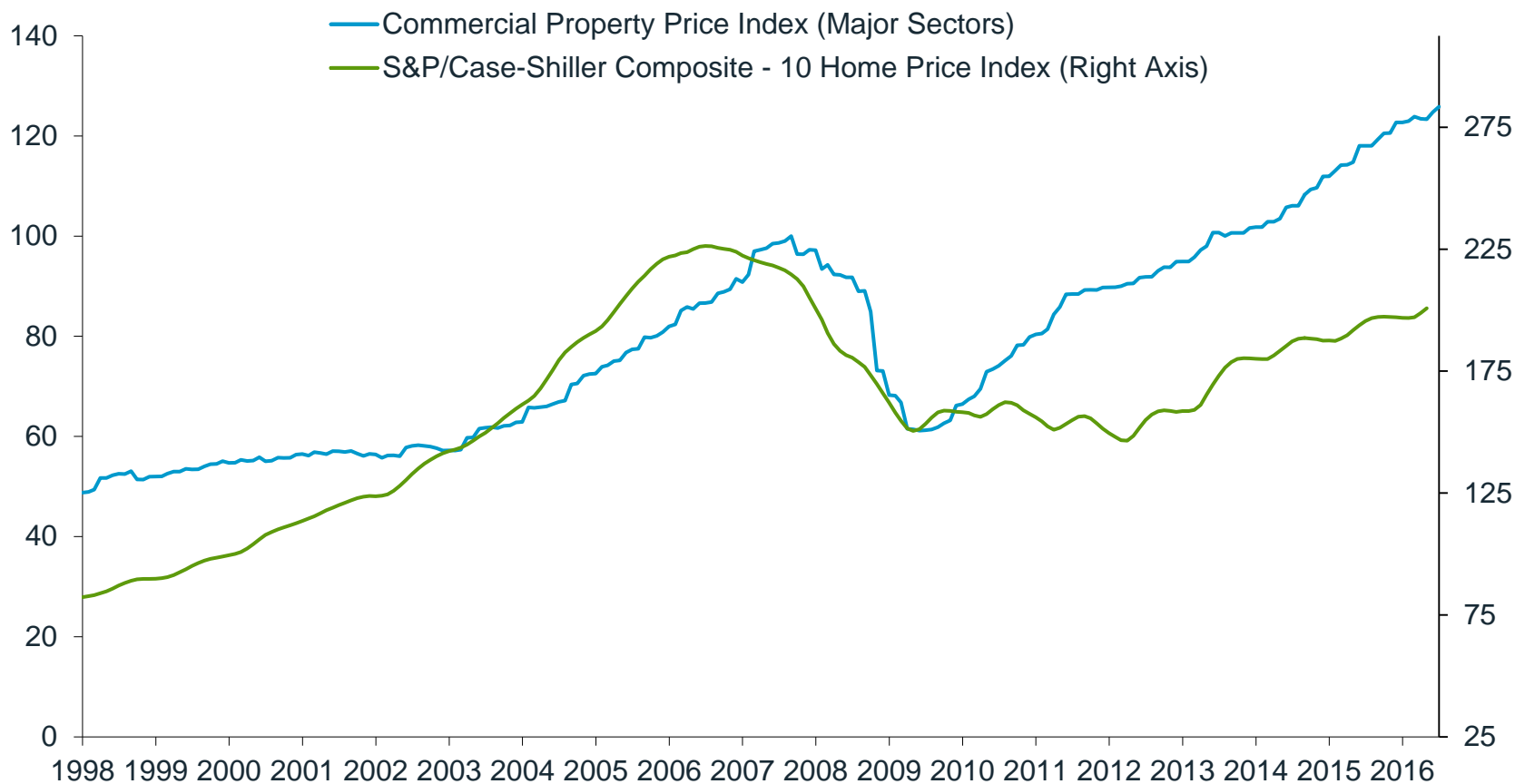


# U.S. Commercial Real Estate Values Increasing

Commercial property prices have surpassed 2007 peak levels while single-family residential property prices are recovering more slowly



## Commercial Property vs. Single-family Housing Prices



Source: Green Street Advisors and FactSet as of 07/01/2016 and 04/30/2016.

Note: Green Street Advisors' Commercial Property Price Index is a time series of unleveraged (= real individual properties) U.S. commercial property value.

GSA CPPI captures the prices at which commercial real estate transactions are currently being negotiated and contracted.



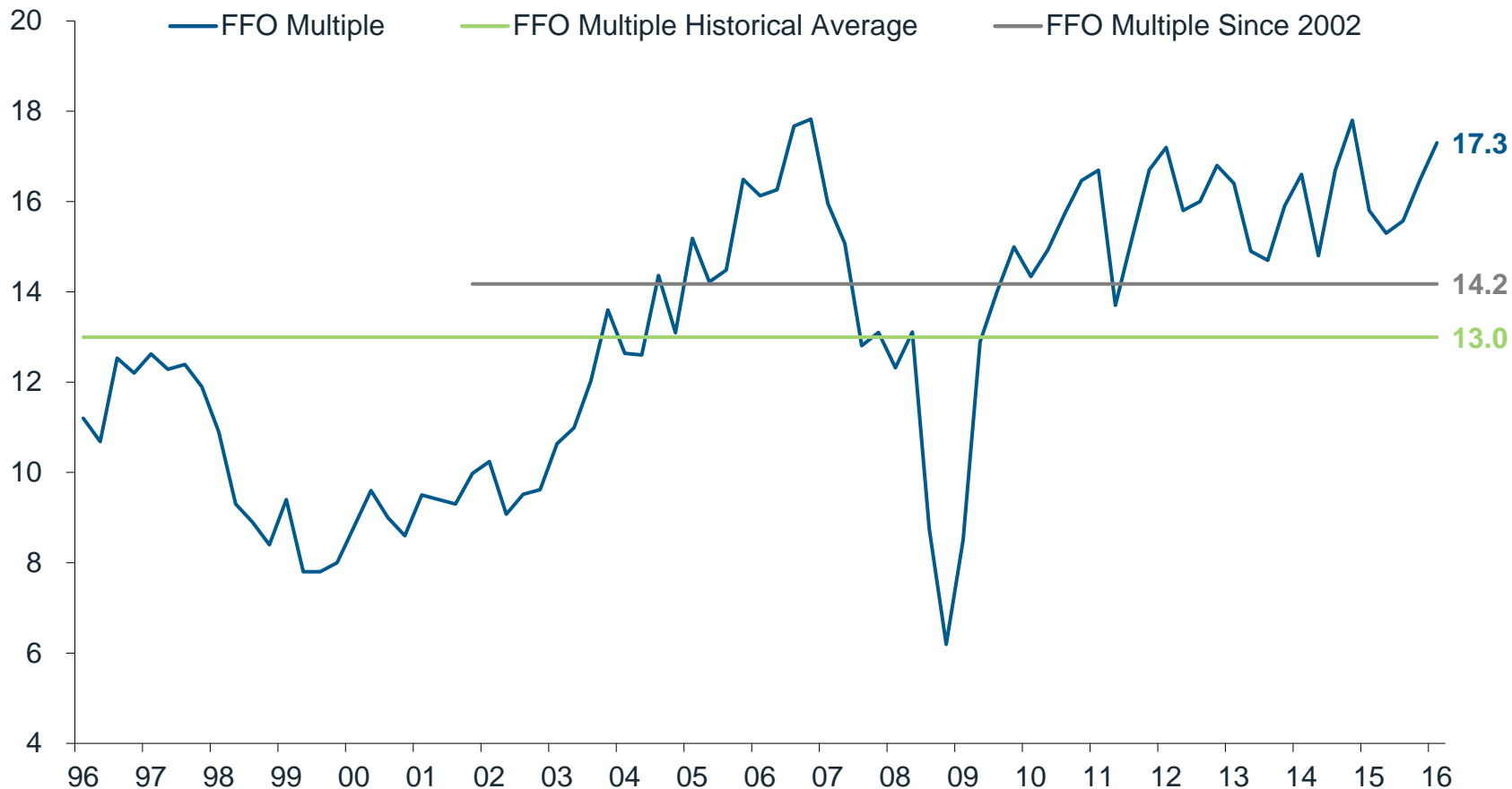


# Valuation

REITs appear slightly expensive on an earnings multiple basis



### REIT FFO Multiple



Note: REIT FFO Multiple is the share price/funds from operations (FFO) and is a valuation measure like PER for the other stocks. FFO is calculated by adding depreciation and amortization and amortization expenses back to earnings.

Source: Citi Investment Research as of 06/30/2016.

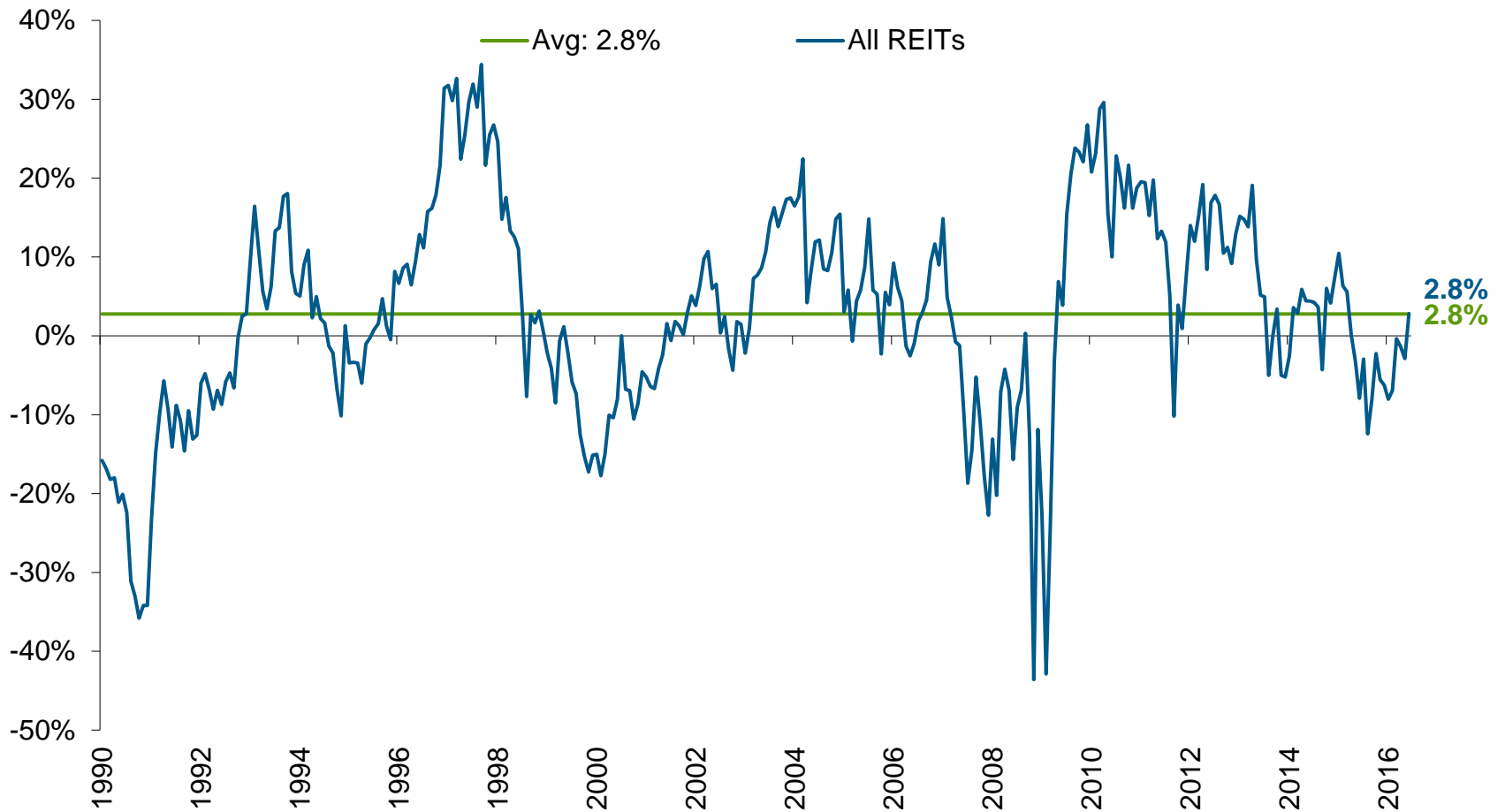


# Valuation

REITs appear fairly valued relative to the net asset value of their underlying properties



### REIT Premium/Discount to NAV



Note: REIT Premium/Discount to NAV reflects the relationship between REIT prices and the value of the underlying REIT properties or the net asset value (NAV). Premium—REITs trading above NAV Discount—REITs trading below the NAV.

Source: Green Street Advisors as of 07/01/2016.

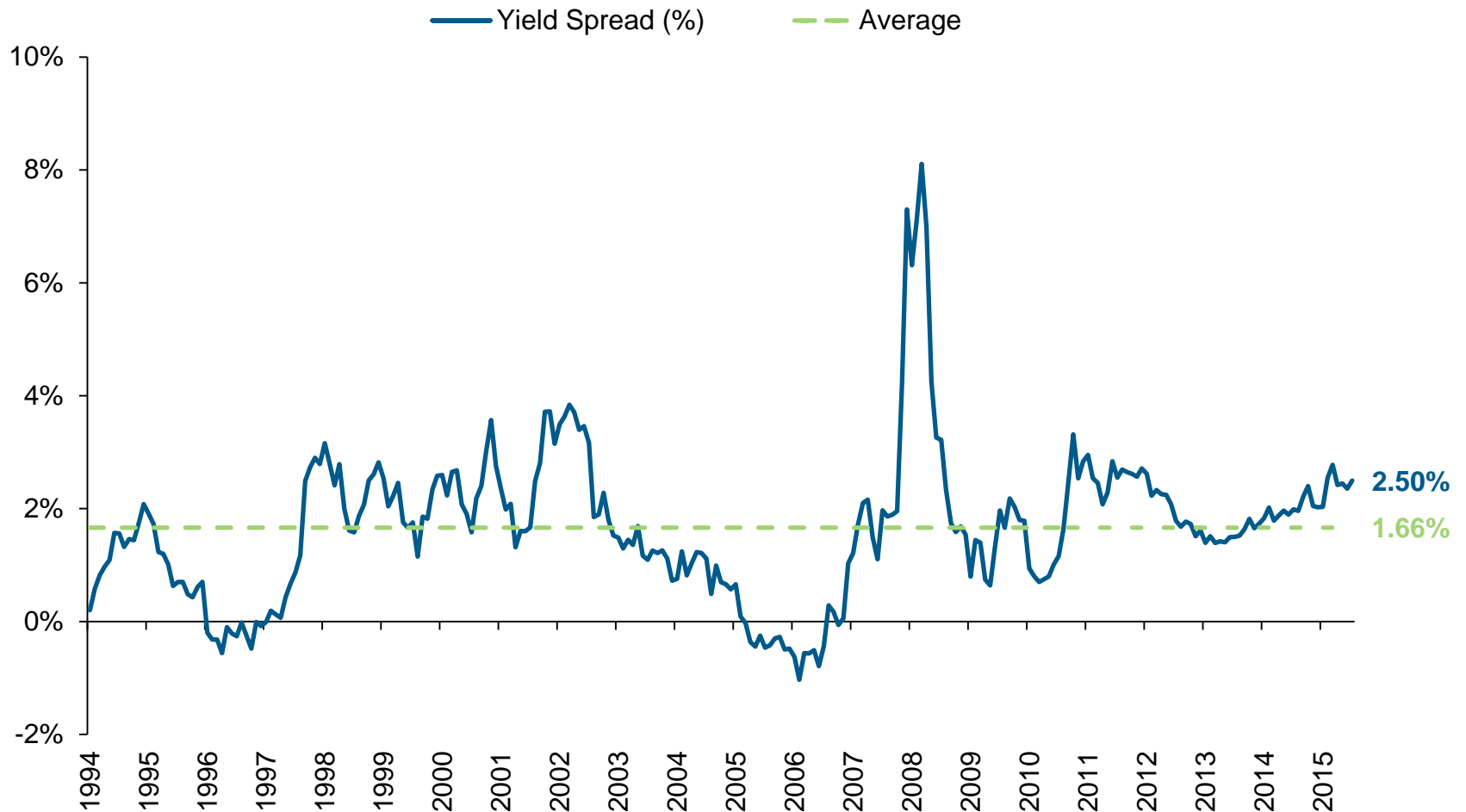


# Valuation

Dividend yields for REITs remain above their historical average spread versus government bond yields, offering a cushion against future interest rate increases



## REITs Dividend Yield vs. 10 Yr. Treasury Bond Yield



Source: FactSet, and National Association of Real Estate Investment Trusts (NAREIT) as of 06/30/2016.



# Fidelity Real Estate Investment Portfolio (Ticker: FRESX)

Managed by Steve Buller since October 1998



## OBJECTIVE

Seeks above-average income and long-term capital growth, consistent with reasonable investment risk. The fund seeks to provide a yield that exceeds the composite yield of the Standard & Poor's 500 Index

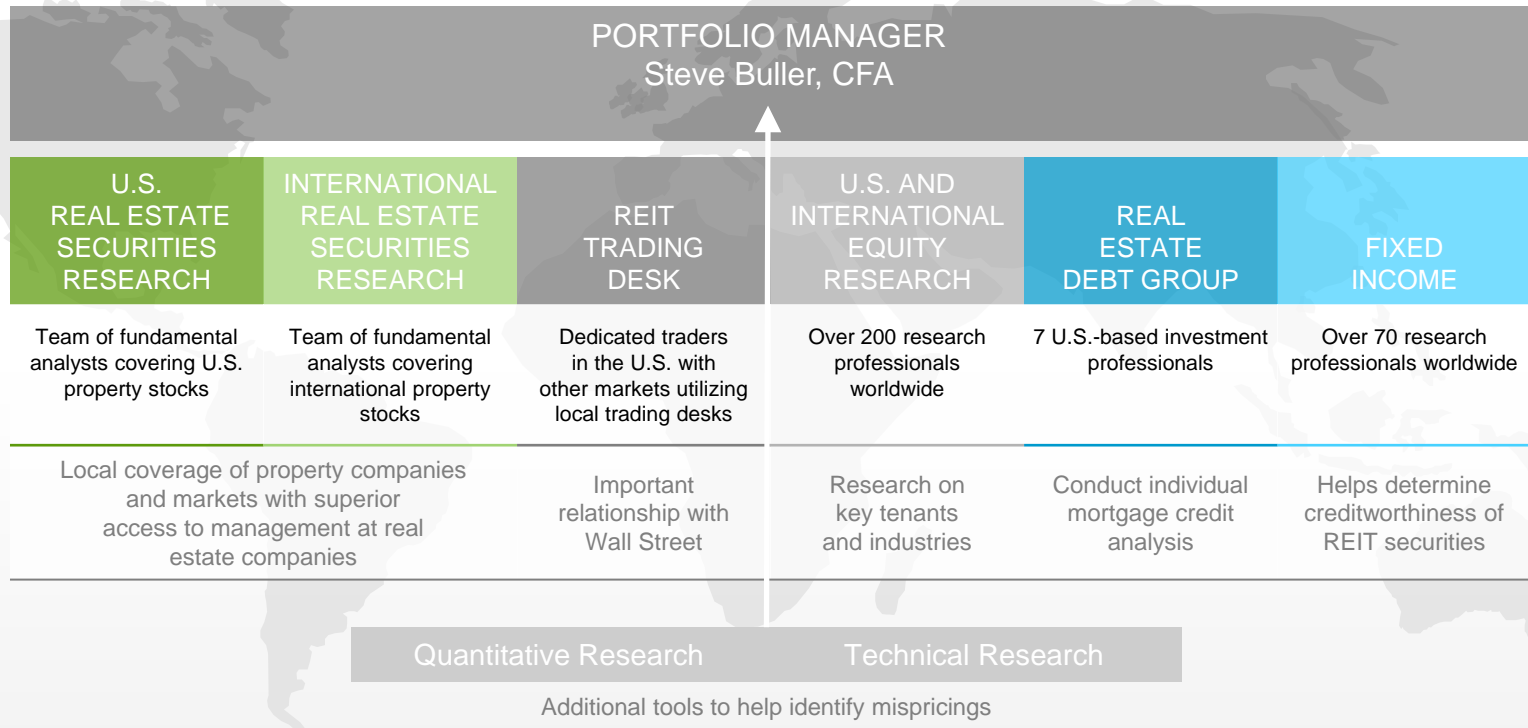
## BENCHMARK

- Dow Jones U.S. Select Real Estate Securities Index
- S&P 500 Index

## INVESTMENT APPROACH

- \$5.21 billion in assets as of June 30, 2016
- One of the industry's oldest real estate funds—1986 inception
- Only two portfolio managers since the fund's inception
- Current manager since October 1998

# Portfolio Manager Utilizes Fidelity's Global Resources



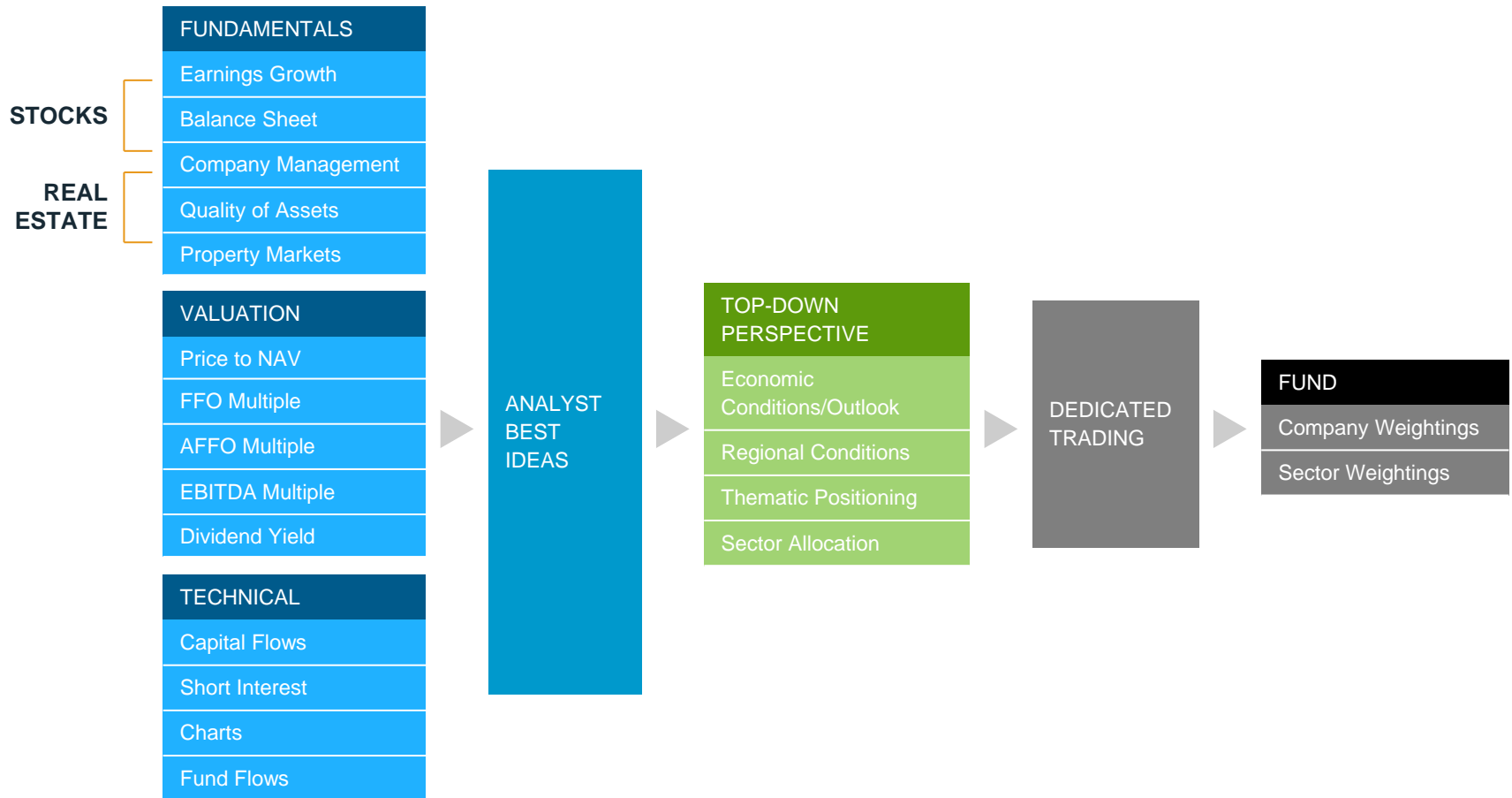
Source: Fidelity Investments as of June 30, 2016.



# Investment Process



## BOTTOM-UP RESEARCH



# Portfolio Positioning



**Current portfolio positioning is slightly more defensive, owning more Healthcare REITs and Triple-Net REITs.**

## **Other major themes in the portfolio include:**

- Stocks that exhibit GARP (growth-at-a-reasonable-price) characteristics
  - Finding opportunities in REITs that have similar growth characteristics to the broader REIT market, but currently trade at a discount to the REIT group or to their historical valuation measures
- Stocks that are positioned to benefit from a corporate event
  - Events could be driven internally by management/board or externally by activist investors
  - Events could include spinout, asset sales, etc. to unlock value

# Summary & Outlook



- The long-term performance of REITs has been strong in both absolute and relative terms
  
- We have a positive outlook for U.S. REITs and continue to monitor fundamental, valuation, and capital considerations:
  - The fundamentals for REITs continue to be favorable: Growth is still positive, and we project further rent increases in a majority of property sectors and markets, however the pace of growth is no longer accelerating.
  - Access to and cost of capital remain good with higher credit costs offset by lower long-term interest rates.
  - REITs are fairly valued.



# Sector Resources on Fidelity.com

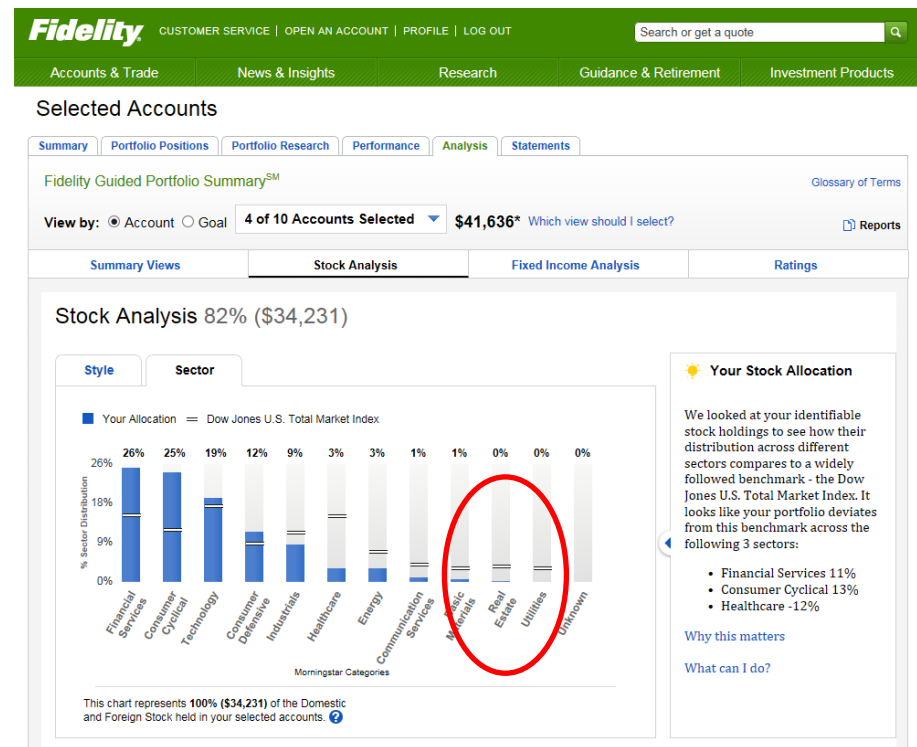


## GPS (Guided Portfolio Summary) Review Sector Allocation

### The Fidelity Guided Portfolio Summary:

- On Stock Analysis tab, GPS shows sector allocations compared to the market.
- Uncover underweight or overweight sectors.
- Is this consistent with existing financial goals and/or market outlook?

[www.fidelity.com/gps](http://www.fidelity.com/gps)



For Illustrative Purposes Only.



# Important Information



**10 Yr. Treasury Bond Yield:** The return on investment, expressed as a percentage, on the U.S. government's debt obligations (bonds, notes and bills).

**Coefficient:** A number or symbol by which another number or symbol (as a mathematical variable) is multiplied.

**Correlation:** a statistical measure of how two securities move in relation to each other. 1.0 meaning they move the same, and anything less than that meaning they are moving in different directions and less correlated.

**Dividend Yield:** a financial ratio that shows how much a company pays out in dividends each year relative to its share price. In the absence of any capital gains, the dividend yield is the return on investment for a stock.

**Earnings Per Share Growth:** A company's profit divided by its number of common outstanding shares.

**MSCI Barra U.S. Equity Long-Term Model** is a model designed to analyze and forecast sources of performance and risk for investments in the U.S. market. The Long-Term model incorporates the a set of style factors reflecting long-term strategies that aim to keep portfolio turnover and transaction costs at low levels.

**FTSE NAREIT All Equity REITs Index** is a market capitalization-weighted index that is designed to measure the performance of tax-qualified Real Estate Investment Trusts (REITs) that are listed on the New York Stock Exchange, the NYSE MKT LLC, or the NASDAQ National Market List with more than fifty percent of total assets in qualifying real estate assets secured by real property. Mortgage REITs are excluded.

**MSCI USA Investable Market Index (IMI) Sector Indexes** are derived from the broad MSCI USA MSCI USA IMI Sector Weights Investable Market Index (IMI), which includes over 2,400 large, mid and small cap US stocks and represents a market capitalization of about \$18 trillion.

**S&P 500 Index** is a market capitalization-weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation to represent U.S. equity performance.

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Real estate is a cyclical industry that is sensitive to interest rates, economic conditions (both nationally and locally), property tax rates, and other factors.

Because FMR concentrates the funds' investments in a particular industry, the funds' performance could depend heavily on the performance of that industry and could be more volatile than the performance of less concentrated funds and the market as a whole. The funds are considered nondiversified and can invest a greater portion of assets in securities of individual issuers than a diversified fund; thus changes in the market value of a single investment could cause greater fluctuations in share price than would occur in a more diversified fund. Third-party trademarks and service marks are the property of their respective owners. All other trademarks and service marks are the property of FMR LLC or an affiliated company.

**Before investing, consider the funds' investment objectives, risks, charges, and expenses. Contact Fidelity for a prospectus or, if available, a summary prospectus containing this information. Read it carefully.**

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