Real Estate Returns Following Fed Rate Hike Cycles

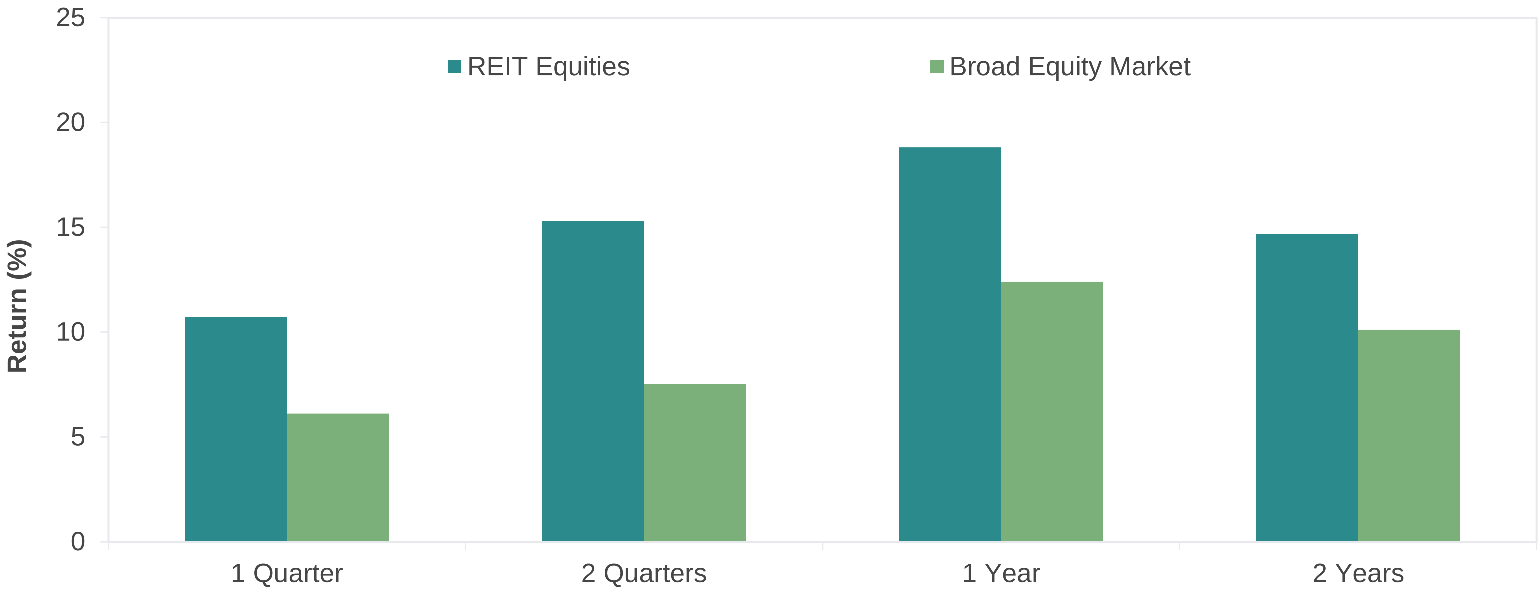
July 2023

Over the last 15 months, the Federal Reserve (Fed) has meaningfully raised the benchmark fed funds rate in an effort to tamp down inflation. The Fed paused its hiking campaign during the June meeting, but issued an outlook suggesting additional rate increases are to be expected. Regardless of whether the Fed has finished raising rates, we believe the end of the tightening cycle is near and view now as a prudent time to examine the performance of Real Estate Investment Trust (REIT) stocks following historical periods of fed funds increases.

REITs have meaningfully underperformed the broad market throughout the Fed's current hiking cycle. The real estate sector, as represented by the FTSE NAREIT All Equity REIT Index, declined nearly 25% in 2022, while the broad equity market, represented by the S&P 500® Index, fell approximately 18%. The underperformance of REITs broadened in the first half of 2023 with the real estate sector rising less than 3% while the S&P 500® gained nearly 17%.

History suggests REITs' recent relative underperformance will reverse when the Fed is done raising rates. An examination of returns for both REITs and the broad market following the Fed's last three tightening cycles, which concluded in 2000, 2006, and 2018, show public REITs outperforming the S&P 500® over the short- and medium-term periods after the Fed's last rate hike.

Average Total Return After Fed Tightening Cycle[1]



We believe REITs' historical relative outperformance versus the broad equity market has been due to the removal of a major uncertainty in valuing real estate – the cost of debt. When interest rates are rising, investors continually re-price the cost of debt higher while leaving additional margin for future increases, causing equity prices to fall. Once the terminal fed funds rate becomes known and interest rates stabilize, REIT share prices typically rebound from what was an overshoot to the downside. Though every market period is unique, history suggests that REITs are set for a similar relative "bounce back" once this Fed hiking cycle is complete. The periods covered in the average include the post-Dot-Com era, the Great Financial Crisis, and the COVID-19 pandemic – a diverse set of market crosscurrents, to say the least.

[1]Average returns in the one, two, four, and eight quarters after 06.30.2000, 06.30.2006, and 12.31.2018. REIT Equities represented by the FTSE NAREIT All Equity REIT Index and the Broad Equity Market represented by the S&P 500 Index. Chart source: Bloomberg L.P.

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Important Information

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Andrew T. DiZio, CFA®, Executive Director, joined the Stratton Funds team of Stratton Management Company in 2012 and Sterling Capital Management as part of a business acquisition in 2015. He has investment experience since 2003. Andy is co-portfolio manager of the Sterling Real Estate and Sterling Mid Cap Relative Value strategies and associate portfolio manager of the Sterling Small Cap Value strategy. Prior to joining Sterling, he was vice president at Janney Montgomery Scott where he served as a Real Estate Investment Trust sector analyst. Andy received his B.S. in Finance with a minor in Economics from Pennsylvania State University. He holds the Chartered Financial Analyst® designation and is a member of the CFA® Society of Philadelphia and the CFA® Institute.

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The FTSE NAREIT All Equity REITS Index contains all tax-qualified REITs with more than 50 percent of total assets in qualifying real estate assets other than mortgages secured by real properly that also meet minimum size and liquidity criteria. The FTSE NAREIT U.S. Real Estate Index Series is designed to present investors with a comprehensive family of REIT performance indexes that spans the commercial real estate space across the U.S. economy. The index series provides investors with exposure to all investment and property sectors. In addition, the more narrowly focused property sector and sub-sector indexes provide the facility to concentrate commercial real estate exposure in more selected markets.

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