

Prospects for 2019 - Revisited



Half-way through the year, which way are the scales tipping now?

2019 Revisited

Bull and Bear have met for their half-year catch-up before setting off on their summer holidays.

Bear: Bull, what on earth were you thinking? Making thirty predictions for the year was madness? Thirty! We were bound to be caught out on something or other. And, embarrassingly, we got the very first one horribly wrong. We said that an Agreement on Brexit would be reached with the EU by 29 March.



Bull: We didn't get that wrong at all. We did reach an Agreement. We agreed to extend the exit date to 31 October! And frankly, overall, I think we have done rather well so far:

- Mrs May has resigned;
- FTSE 100 has already reached 7,500 from a start point of 6,728 in January;
- The main parties did lose ground in the European Elections;
- Manchester City did win the Premier League;
- The USA did win the Women's Football World Cup;
- England did win the World ODI World Cup; and
- Novak Djokovic did win Wimbledon.

Bear: And Boris? You said Michael Gove would win the race to be the next PM (and I quote) 'by a furlong'.

Bull: Okay, but if you want to be picky like that (and I quote) we also said... 'Bull is a big fan of Boris'. But come on Bear, the folks don't want all this squabbling. They want to know what's happening in the market. So, let's just take a quick look at each of our start-of-the-year predictions and see whether we are still on track.

Bear: Fair enough. Shall I go first? We said:

- There would be no General Election in 2019 – We are rather less confident now than we were in January. There is no telling what Boris will do.
- GDP growth would exceed 1.2% - We are still moderately confident;
- Interest rates would not rise above 0.75% - We are very confident. In fact, the probability is that they will now come down;
- 10-year gilts will remain below 1.30% - We are very confident, not least as they are now flirting with 0.60%;
- Sterling will appreciate by 5% (to US\$1.33) – To be fair, this prediction was a bit of a flier. We took the view that sterling would probably fall by 5% if we couldn't strike a decent Brexit deal but, equally, would rise if we exited gracefully. Boris needs to pull an amazing rabbit out of the Brexit hat if we are to be right on this one!

Bull: On the sporting front, we are so odds-on to be right about England winning the Ashes and New Zealand winning the Rugby World Cup that we may as well cut straight to the property section. Back to you, Bear.

Bear: Let's deal with the downside stuff first. We said that the High Street would continue to suffer. And it has, and it will continue to do so. Arcadia, LK Bennett, Debenhams, Ladbroke's, Oddbins, Patisserie Valerie, Steamer Trading and more, have all succumbed to a larger or lesser degree. Rents are under pressure and, according to CBRE, All Shops prime yields have already risen by 0.23% since the start of the year and they are still rising.

Of course, the retailers have plenty of excuses, including the unfair competition from internet shopping, draconian business rates and Brexit. But the reality is that they have been over-exuberant in their expansion and, with the winds of fortune now blowing in the wrong direction, they aren't fleet-footed enough to deal with it. Let's face it, we simply have too many shops here in the UK. And if you are looking for a bloody tale, the shares in intu and Hammerson, both specialist retail REITs, are currently trading at discounts to NAV of 70% and 60% respectively.

Bull: Those discounts look really juicy to me. And, sooner or later the retail sector is going to bounce-back and, when it does, I don't want to miss out.

Bear: That's a fair point but that won't be until next year at the very earliest. Meanwhile the rest of the market is holding up alright and, unless Boris does something completely bonkers, we should still be confident with our start-of-the-year predictions that:



- Regional office rents will see some modest rental growth;
- Industrials will outperform the mainstream sectors again; and
- The institutions will keep on building up their residential and BTR portfolios.

So Bull, how do you see the capital markets playing out in the second half?

Bull: I'll be frank with you, Bear... during Q2, I was feeling a bit jittery. All that wall-to-wall negative coverage on Brexit and Mrs May really got to me. And, I fear that once the summer sports and holidays are over, the media will jump on the doomsday bandwagon again. Even so, I now think that there is probably as great a chance of yields compressing further as there is of them rising.

Bear: What???

Bull: Yes. Hear me out.

- I accept that commercial property investment volumes probably won't reach £50 billion this year. After all, according to JLL, the half-year tally is only £21.9 billion. That said, we must avoid falling into the historic trap of believing that, just because the brokers are bemoaning their poor deal flow (and their fees), the market is in a bad place. It really isn't.

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- The London office market has been much more resilient than the doomsayers were ever suggesting. We said it would confound negative expectations and it has. Moreover, it has retained its Number One ranking for the ninth year in a row in St Bride's World Cities Index. And that is largely because of the market's unparalleled liquidity and transparency, and the UK's overall rule of law. The bottom line is that the UK is still the safest place in the world to invest.

- Historically, prime office yields in London and Paris were always the lowest in Europe. However, over the past couple of years, the likes of Amsterdam, Berlin, Frankfurt, Milan and Munich have all seen their yields go lower than in London. I know we are facing Brexit here, but... really?

- And, our good friends at UBS REPM have produced an interesting graph which illustrates beautifully how UK office capital growth has fallen behind that of Continental Europe. So, in my view, once Boris has sprinkled his magic dust, overseas investors will revert to the UK again. And, at that time, yields will start to compress again.

Bear: I get your drift and, although (as usual with you) there is a lot of wishful thinking there, you could well be right. What I thought you were going to say though was that the yield gap between UK property and UK 10-year Government bonds has widened to about 4%. Now that is juicy! And with the probability of bond yields now staying lower for longer, we could well see our own domestic institutions wanting to increase their allocation to property. We said at the start of the year that 2019 would be all about income and I am sure we will be right on this. And with the All Property Yield currently standing at 4.6%, why wouldn't the funds want to up their exposure?



Bull: So where does that leave us on our prediction for the sector's overall total return for 2019? Everyone else seems to have been steadily marking down their forecasts, no doubt because of the high weighting of retail in the IPD/MSCI Universe. But, I just have a sneaking suspicion that the other sectors will come to the rescue. So, I'd be happy to leave our forecast at 3.75% for now... and see what happens. It's not great, but at least it's positive.

Bear: Okay. That's a bold call. Let's hope Boris can do the business or we are all doomed!!

Bull: "All doomed"? You are beginning to sound like Private Fraser in Dad's Army. Are you sure you aren't related?

Total Return Prediction

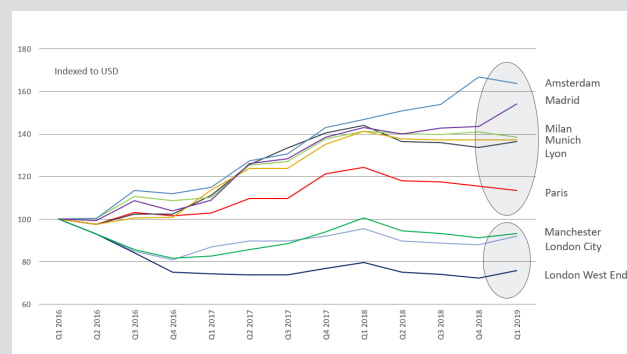
St Bride's Managers are still predicting (rather bullish) All Property Total Returns for 2019 will be 3.75%

St Bride's World Cities Index

Rank 1 – 10			Rank 11 – 20		
2011	2019		2011	2019	
1	1	London	11	11	Amsterdam
7	2	Tokyo	16	12	Chicago
4	3	New York	19	13	Melbourne
5	4	Paris	15	14	Seoul
8	5	Sydney	14	15	Munich
3	6	Singapore	12	16	Berlin
2	7	Hong Kong	18	17	Boston
13	8	Los Angeles	17	18	Washington D.C.
10	9	Toronto	-	19	Madrid
20	10	San Francisco	-	20	Atlanta

Source: St Bride's Managers/Brockwell

UK Office Capital Value Growth



Source: UBS REPM

All Property Commercial Property Forecasts

IPF Consensus	Capital Growth (pa)	Total Return (pa)
August 2018	-1.60%	3.20%
November 2018	-1.70%	3.00%
February 2019	-2.30%	2.40%
May 2019	2.80%	1.80%

Source: IPF

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