



Property funds - The gate escape

We received news yesterday of the suspension of trading in the M&G Property and the Standard Life Ignis UK Property funds. The managers of both of these funds have taken the decision to close, or “gate”, the funds in order to stop redemptions depleting the cash in the funds to a point where they would become forced sellers of property assets; the real bricks and mortar properties in which they are invested around the UK.

This is the most direct action that a fund manager can take to protect a property fund and comes on top of a move to bid pricing which Henderson, Standard Life and M&G undertook back in May to try to stem outflows. At the time, this appeared to work. Indeed, M&G temporarily restored normal pricing but when redemptions resumed, they moved to bid pricing again. However, the resulting volatility in all asset classes in stocks, bonds and currencies appears to have brought the fund managers to the conclusion that a suspension of trading is the best way to protect investors in the fund.

We want to reassure our clients that TAM portfolio exposure to property was already very low as we took good profits in March, selling nearly all of our property funds, when they were trading around 10%

higher than today. Those residual investments that remain are among the smallest weightings that we maintain in client portfolios for long term diversification and this development will have a negligible effect on performance.

To understand how the situation evolved, one needs to go back to 2014 when Gilt yields started to fall, significantly dragged down by low interest rates around the world and the gradual dawning that the Federal Reserve was unwilling to raise their interest rates as far and as soon as they had originally forecast. The European Central Bank drove yields lower as they continued with their quantitative easing which involved the buying of bonds and it wasn't long before we saw bonds trading with zero and negative yields – in other words, a new buyer of the bonds would be guaranteed a loss if the investment was held to maturity.

The hunt for yield was on. Property funds yielding between 7-9% on a gross basis were suddenly very attractive and offered a sensible alternative to bonds whilst still offering some diversification away from equities. The investment rationale was entirely reasonable given the stable economy and healthy secondary market. At TAM, we invested client portfolios into property in around April 2014 and built up the investment until the summer of 2015 when they started to make up 20% of balanced portfolios and performed very well without any volatility. However, in February of this year, we took another look at property generally. Markets had started the year with some volatility in response to the Federal Reserve U-turn on their plan to aggressively raise interest rates, citing weakness and uncertainty in the economy. Although there was nothing intrinsically wrong with the property sector at that time, it seemed reasonable that, at some point, a slowing of the economy and the prospect of a recession, not to mention the EU referendum risk, would surely spill over into the property sector with all the associated risk that valuations would ultimately be marked down.

We took the decision to start selling in March this year and reduced balanced portfolios from a weighting of over 20% to around 5%. This in itself was an interesting exercise because, in the process of selling, we realised that liquidity was not as good as previously thought. We found that quite small redemption sales needed careful handling and took a little longer. We took big profits, the selling was completed and all TAM client portfolios carried on with a significantly reduced exposure to property.

Having noted low liquidity during this time, it wasn't entirely surprising when some of the funds started to introduce bid pricing in order to dissuade investors from selling. Although disappointing, it was likely to be a short term measure and, in any case, we had a vastly reduced position with good profits.

The extent to which Brexit alone is responsible for forced selling of the funds leading to gating is not clear cut. We are aware, for example, of shorting (selling shares one doesn't own) has had a hand in the daily redemptions from these funds, and there has been price volatility in UK markets generally, albeit on low volumes but in a nervous and uncertain environment.

For now, there is nothing to be done except to follow the situation closely and await the re-opening of the funds to normal trading. The assets in the funds are very high quality and commercially viable and the management of the funds will continue under the management of large and well-resourced investment professionals with proven track

records of successful property investing. The funds will continue to be priced according to the market value of their commercial property assets. Whilst the gating of the funds does not afford us the flexibility we normally enjoy, we do not expect this development to materially impact TAM client portfolios which remain well-diversified and are conscious that the managers of the closed funds will be anxious to re-open them at the earliest possible opportunity.

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