RANGER GLOBAL REAL ESTATE ADVISORS

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Where We Are in Historical Context - And a Look Ahead

To set the table for the more detailed discussion to follow, here are some observations and principles that we believe serve as reliable markers to guide one's investment decision-making process:

1) **Commercial real estate is a long duration asset class.** Yes, REITs are stocks and thus during periods of market stress they will move in correlation with other risk assets, but eventually they will reflect the value of their underlying assets. Your REIT investment is an *allocation*, not a trade.
2) **Globally, REITs are on average trading at big discounts to NAV** (the private market value of their assets). We can buy high-quality commercial real estate cheaper in the public market than in the private market.
3) **REITs have bond-like characteristics that offer some defensive qualities,** but importantly they also offer growth and have the potential to create value from improving operations, investing wisely and harvesting value when appropriate. REITs' portfolio cash flows are expected to continue to rise over the next few years, and REITs' low dividend payout ratios mean that companies are retaining significant free cash flow, thus lifting NAVs.
4) **"Bull markets don't die of old age; they die of excesses."** In the business of commercial real estate, the culprit has historically been *excess new supply*, which shifts the balance of pricing power from the landlord to the tenant. When that happens, rents stop going up, they peak and start falling. **New supply has historically been the catalyst to cause the top of the cycle.**

While there are valid concerns about geopolitical risk, macroeconomic stress and the perceived impact of potential higher interest rates, the underlying drivers of the commercial real estate business remain very strong and supportive of positive total returns:

- Operating fundamentals are solid as a growing global economy leads to stronger rent and occupancy growth.
- Capital is widely available at historically low costs.
- Property valuations (cap rates) currently reflect an embedded "cushion" for at least 160 bps of higher yield on 10 year Treasurys. Commercial real estate cap rates as a spread to 10-year Treasury rates has historically averaged 200 bp. That spread is now much wider, at 360 bp. **This suggests that bond rates could move up by at least 160 bp or more without having a significant impact on cap rates and private real estate values.**
- While new supply is increasing, it remains well below historical norms.
- Real estate private equity funds are holding a record $275 billion in undeployed capital. Private equity funds have shown a strong appetite for acquiring institutional-quality properties or even entire companies at the current discounts to NAV, which in effect provides a floor to REIT share prices.

- Global investors can find better value and higher risk-adjusted returns outside the U.S. In addition to greater diversification, they can also get exposure to countries that are growing faster and operating at different points in their own economic and monetary cycles. While the U.S. Fed is publicly contemplating the beginning of their tightening cycle, most of the other large global economies are still years and in some cases many years behind the U.S. as their central banks are in the early stages of their own easing cycle.

Global REITs, as a subset of the broader real estate industry, are benefitting from all of these trends and also from their strong balance sheets and dividend yields that remain relatively attractive to income-oriented investors. But are these trends already completely played out? The drop in share prices in 2015 fueled investor concerns about whether we had reached a “top”. In our view, we don’t think so. Lending is rational, even constrained. New supply is moving up, but not to levels of concern. Interest rates remain very low and a spike seems unlikely. The global economy is relatively healthy, so a pull-back in fundamentals doesn’t appear in the cards. So yes, things are good - or at least good enough - but we don’t think they are so good as to suggest a top. That said, returns from here will be more dependent on each company’s ability to create value from internal and external sources, rather than simply cap rate compression - **i.e., a stock-picker's market which plays to our strength**.

While the threat of a Fed rate hike may become a reality within the next three months, **the listed real estate sector historically has not been negatively impacted by the Fed raising rates.** The Fed tightening cycle from 2004-05 is most similar to the current period, in terms of where we are in the physical real estate cycle. **Ahead of the 2004-05 Fed rate hiking period, the listed real estate market corrected 15% going into the first rate hike and then performed well through the subsequent rate hikes.** For virtually all listed real estate markets, central bank rate hikes didn't negatively impact performance. Why is this? REITs are commercial real estate, which is priced off the long end, not the short end of the rate curve. Thus, the performance of the listed real estate universe will depend more on the movement in 10-year Treasury yields, not on short-term rate hikes. Note that consensus expectations for the 10-year Treasury yield call for an increase of only 120 bp to 2.8% by the end of 2017. **If this holds true, we do not expect any negative impact on commercial real estate values.**

Where Are We in the Real Estate Cycle?

Commercial real estate cycles are driven by two factors: 1) the demand for existing space, and 2) the supply of new space. Of these two factors, new supply has almost always been the cause of the cycle peaking and the ensuing downturn in rents, occupancy and property-level cash flow. Without new supply from development, the balance of pricing power remains with landlords, enabling them to raise rents and maintain (or grow) occupancy, driving property-level cash flow higher. Until new supply shifts the balance of pricing power to tenants, the real estate cycle will continue its upward climb as long as GDP growth remains self-reinforcing (above 3% on a global basis).

The combination of no new supply (for the first time in several real estate cycles), slow but steady economic growth and continued access to inexpensive and plentiful capital has created a “Goldilocks” scenario for commercial real estate. In this environment, we believe that well-capitalized real estate companies (e.g., most listed REITs) can continue to perform well, provided that the global economic recovery continues, which is still our base case.

Analyzing the Historical Context of Demand, Supply and Rates

We continue to see commercial real estate, and by extension global REITs, as in the middle stages of a long-term bull market predicated on the “Goldilocks scenario” of:

1) **enough GDP growth to drive incremental demand** and give landlords the pricing power to push rents higher while maintaining (or increasing) occupancy;
2) but not enough GDP growth that development makes economic sense in most markets, thus **limited new supply** (without new supply to give tenants other options, rents can continue to rise); and,
3) **historically-low interest rates** that provide a tailwind for a capital-intensive business like commercial real estate.

A Closer Look at Demand

The current forecast for global GDP growth is comfortably above "escape velocity" where the economic recovery remains self-reinforcing. Moreover, the U.S. economy shows little if any risk of recession. We also believe that the only scenario where the Fed would begin to tighten rates (*sustainable* economic growth) is also inherently bullish for commercial real estate fundamentals, thus offsetting much of the negative impact of higher interest rates.

A Closer Look at Supply

Construction starts remain quite low at only 1% of existing stock. To put the level of new supply into context, since 1970 the historical average of starts has been ~2% of existing stock. In addition, the normal obsolescence rate has been ~1.2% of stock annually - so existing stock is aging more quickly than new stock is being added--resulting in *negative new supply*. With GDP growth not strong enough to ramp up new supply, we don't see anything even on the horizon (12-24 months—the length of the construction process) that would derail the recovery in commercial real estate and the bull market for global REITs.

A Closer Look at Interest Rates and REIT Returns

In the context of the long-term history of 10-year Treasury yields, the current 1.6% yield is obviously quite low and provides a very strong tailwind for commercial real estate. Even if rates were to move up 200 bps —driving the 10-year Treasury up to 3.6%, there'd still be a tailwind for REITs. How high would rates have to go before the cost of debt capital would become a true headwind? The cross-over point would be 4% on the 10-year Treasury. Why 4%? REIT bonds are priced as a spread to Treasurys (currently ~210 bps over for a typical BBB credit), so as long as the 10-year Treasury yield remains below 4%, REITs will be able to re-finance maturing debt (current average rate of 6.10%) *at lower rates*, resulting in lower interest expense (a REIT's single largest expense line on its income statement) and higher cash flow and dividends. Remember also that REITs borrow long (weighted average debt maturity is about 7 years) so it would take many years for the impact of long-term rates over 4% to flow through to result in higher interest expense and reduced cash flow/dividends.

How likely is it that rates move up to the level where they become a headwind? In our view, this scenario is not very likely over the next 2-3 years. There's still too much slack in the global economy, still some de-leveraging yet to happen, and some structural impediments to the four biggest economies: the U.S. (fiscal policy, Obamacare), China (transition from an export-led economy to a consumption based economy), Japan (demographics and deflation) and the Eurozone (Brexit and the transformation of a currency-based union into a true political union — which will require weaning the entitlement-rich countries off the dole and back into higher productivity). Empirically, the current implied futures curve shows that the 10-year Treasury yield is expected to remain at very low levels over the next several years - rising only to 2.8% 12 months out and up to 3.2% three years out.

Assessing REIT Returns in the Context of Previous Central Bank Tightening

Conventional wisdom suggests that higher central bank policy rates are bad for public REITs. However, history shows that, on average, global REIT markets have risen 4.5% in the three months' post policy rate hikes and outperformed equities by an average of 2.5%. For U.S. REITs specifically, of the 23 Fed funds rate hikes since June 1999, U.S. REITs have delivered positive returns on 19 occasions, with the average return in the three months post the Fed rate hike being 6% and the outperformance relative to U.S. equities being 4%.

Highlighting Another Advantage of Global REIT Funds

Global REIT funds offer investors many benefits over their domestic-only brethren. In addition to greater diversification and a larger investable universe, they also provide exposure to countries that are growing faster and operating at different points in their own economic and monetary cycles. While the U.S. Fed is publicly contemplating the beginning of their tightening cycle, most of the other large global economies are still years and in some cases many years behind the U.S. China is not only growing at 2-3x the rate of the U.S., its central bank is nevertheless in an accommodative stance as it seeks to engineer a soft landing. The Eurozone is likewise backstopped by a commitment from the ECB to "do whatever is necessary" to support the Euro with an easy monetary policy. Japan, with its "Abenomics", appears to be trying to out-Fed the Fed. Australia recently cut rates and consensus is looking for at least one more rate cut. The moral to the global real estate story: a global REIT fund can find better value and higher risk-adjusted returns outside the U.S.

New S&P GICS Sector - Another Tailwind for Global REITs

S&P's recent (September 1) promotion of REITs as a standalone sector in their Global Industry Classification Standard (GICS) is a huge plus for listed real estate. Previously, REITs were classified under Financials where they were "hidden", allowing most institutional allocators to ignore REITs and get their real estate exposure via direct real estate and private equity funds. Now that REITs are placed in the S&P (as well as MSCI's global indices) GICS spotlight, institutions will be forced to take a stand on REITs and justify their underweights (or in many cases zero weights). If we assume that the institutions that are underweight REITs adopt a neutral-weight position, that alone would drive inflows of many tens of billions. Indeed, CEM Benchmarking (a pension fund consulting firm) published a study which determined that **REITs were the best-performing asset class over the past 18 years**, and that the current exposure to REITs among the top 500 U.S. pension funds is 0.6%--340 basis points below the new Real Estate GICS sector's weight in the S&P 500. **On $6 trillion in assets, that equates to ~$200 billion in new allocations to close the underweight gap.** To put that in context, the total AUM of all REIT-dedicated mutual funds is ~$140 billion.

In addition to the ~$200 billion in potential new investment in public REITs by institutions, another ~$100 billion in new investment could come from generalist equity funds that are currently underweight REITs--on average, about 220 bp underweight. **On $4.9 trillion in aggregate AUM held by these funds, that equates to another $108 billion of potential new investment.**

Clearly, this will be a game-changer for REITs and keep a strong bid under REIT shares as investors acknowledge the higher profile of listed real estate. The creation of a separate Real Estate sector also acknowledges that there are fundamental differences between real estate and other industries. Segmenting coverage and performance attribution of real estate will promote awareness of the sector's distinct investment characteristics and serve as a catalyst for continued growth of the global listed real estate market, giving investors access to a wider range of opportunities with even greater liquidity than is already available.

Summary of the Bull Case for Global REITs

- Growing Global Economy = Good for Commercial Real Estate – A growing economy has historically led to better real estate fundamentals (i.e. stronger rent and occupancy growth) and greater availability of capital. Both of these are positives for real estate and could also mitigate the impact of higher interest rates.

- Strong Private Market – Private market pricing continues to be strong driven by considerable debt and equity capital availability. Attractive private market pricing also provides a backstop to REIT share prices, and potentially could lead to privatizations if discounts to NAV become wide.

- Attractive Valuations Relative to Bonds – Higher interest rates seem partially reflected in public REIT pricing given above-average spreads between bond yields and REIT implied cap rates.

- New Supply Remains at Low Levels – New supply (while off its lows) continues to remain low by all historical standards and supportive of continued gains in occupancy and rental rates.

- Positive Funds Flows – Real estate private equity funds are holding a record $275 billion in undeployed capital--up 15% over year-end 2015. Private equity funds have shown a strong appetite for acquiring institutional-quality properties or even entire companies at the current discounts to NAV, which in effect provides a floor to REIT share prices.

- S&P's recent promotion of REITs to their own standalone Global Industry Classification Standard (GICS) sector is a confirmation of their mainstream acceptance and will be another catalyst to drive incremental capital inflows.

Conclusion and a Look Ahead

Our 2016 forecast is for total return of 12-14%, which could prove to be conservative if institutions and generalist equity funds respond to the GICS change the way we expect them to and allocate a meaningful amount of their assets to REITs. Looking ahead into 2017, our forecast is for a continuation of the bull market in global REITs with a total return of 10-12% (consistent with their long-term historical average total return).

About the Author, ANDREW J. DUFFY, CFA:

Andrew J. Duffy, CFA is the President of Ranger Global Real Estate Advisors, LLC ("Ranger Global") and the Senior Portfolio Manager of the James Alpha Global Real Estate Investments Fund (JAREX / JACRX / JARIX), a mutual fund that invests in publicly-traded global REIT securities. Mr. Duffy has more than 20 years of global real estate securities investment experience.

Prior to co-founding Ranger Global, he was the President and Senior Portfolio Manager of Ascent Investment Advisors, LLC since its inception in February 2009. Before that, Mr. Duffy was a Managing Director with Citigroup Principal Strategies, where he managed a long/short portfolio of global real estate securities. From February 2005 until January 2008 he was with Hunter Global Investors, L.P. where he was the Co-Portfolio Manager of the Hunter Global Real Estate Fund, LP. Before that he was a Portfolio Manager at TIAA- CREF for over six years, during which time he was responsible for managing over $3 billion in global real estate equity and debt securities. Between 1993 and 1999, Mr. Duffy was a Senior Research Analyst at Eagle Asset Management, where he launched and managed a dedicated real estate securities investment program.

Prior to his career in investments, Mr. Duffy served for five years as an officer in the United States Army, where his assignments included serving in the 7th Special Forces Group and the 82nd Airborne Division. Mr. Duffy received a B.S. from the United States Military Academy at West Point in 1979 as a Distinguished Graduate (top 5% of class) and an M.B.A. from Harvard Business School in 1986. He earned the Chartered Financial Analyst designation in 1996.

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