Identifying a set of general equity style and factor guidelines for listed real estate

Alex Moss

One of the key factors inhibiting the growth of the listed sector is the fact that generalist investors, who are the price setters, and drive funds flows and valuations, do not find it easy to group real estate stocks with other equities such as Financials, Information Technology, and Healthcare. As a result, they can often regard the sector as a unified whole and take a sector weighting according to the real estate and economic cycle, rather than maintaining a holding in certain stocks throughout the cycle. Historically, listed real estate has had very real estate-specific labels, be they asset (Retail, Office, Industrial etc) or structure (REIT, PropCo) based. Even adopting the labels of unlisted funds, (Core, Value Add, Opportunistic) does not provide much guidance as listed real estate companies do not have a finite life and listed equity returns are not based on IRRs. In this study, we attach labels to the listed real estate sector which are commonly used by multi-asset fund managers to characterise equities across GICS groups. We draw upon the principles established by Fama and French in their work on factor models. Size, valuation, and leverage factors are utilised in the study, but the labels are expanded to take account of many other key price drivers. Much work has been done in the sector on cluster analysis, showing how companies with similar underlying asset types perform in a similar fashion and therefore provide little in the way of diversification. In this work we look at how clusters can be grouped not by asset type but by theme (exposure to online retail, cloud storage, interest rates, the UK domestic economy etc) across equity sectors, and how including listed real estate in these themes affects performance. We conclude by providing a new set of style and factor guidelines that can be used by generalist equity fund managers which enable them to include real estate stocks in their theme-based strategies.