Principal
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Principal Real Estate

REIT Market Perspectives

Market update and a look ahead

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Risk off! Macro and political uncertainty may favor defense in the year ahead

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Markets are experiencing incredible turbulence this year with Trump imposed tariffs sparking a global trade war and increasing geopolitical tensions. With uncertainty on how these issues will be resolved, downside risks to markets are rising and investors should consider diversifying portfolio risk. In this environment, the performance of listed REITs has been resilient, with REITs off to one of the best starts relative to equity markets in a decade. This paper discusses how listed REITs offer a compelling opportunity as a valuable tool for navigating a challenging year ahead.

Key reasons to own REITs include:

- REITs are likely to be favored by investors in a defensive market rotation
- REITs are relatively insulated from tariffs and other Trump policies
- Slower economic growth is likely and so are lower real yields. Falling real yields can be a big tailwind for REIT market performance.
- Real estate and REIT valuations were already depressed and screening cheap before 'Liberation Day'
- Fundamentals are steady with supply slowing and earnings are durable across most sectors
- REITs provide attractive diversification with low correlations to Mag 7 stocks

Caveats to our outlook:

- A significant economic recession would likely create a material sell-off for all risk assets, including REITs.
- Stagflation is a risk, but this time may be different. Post 'Liberation Day' long-term market-based inflation expectations remain anchored. If the Fed judges tariffs as transitory inflation, this could create a scenario whereby the Fed cuts rates as it prioritizes the employment part of its mandate in an economy facing a recession.

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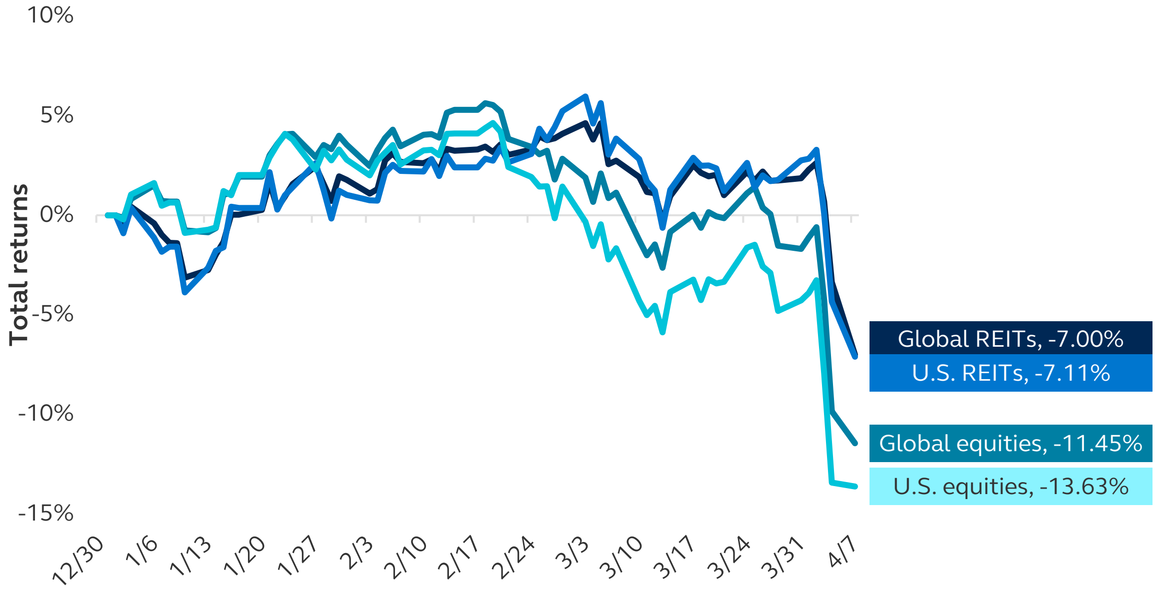
REASON 1

A notable defensive rotation is underway this year, benefitting REIT stocks

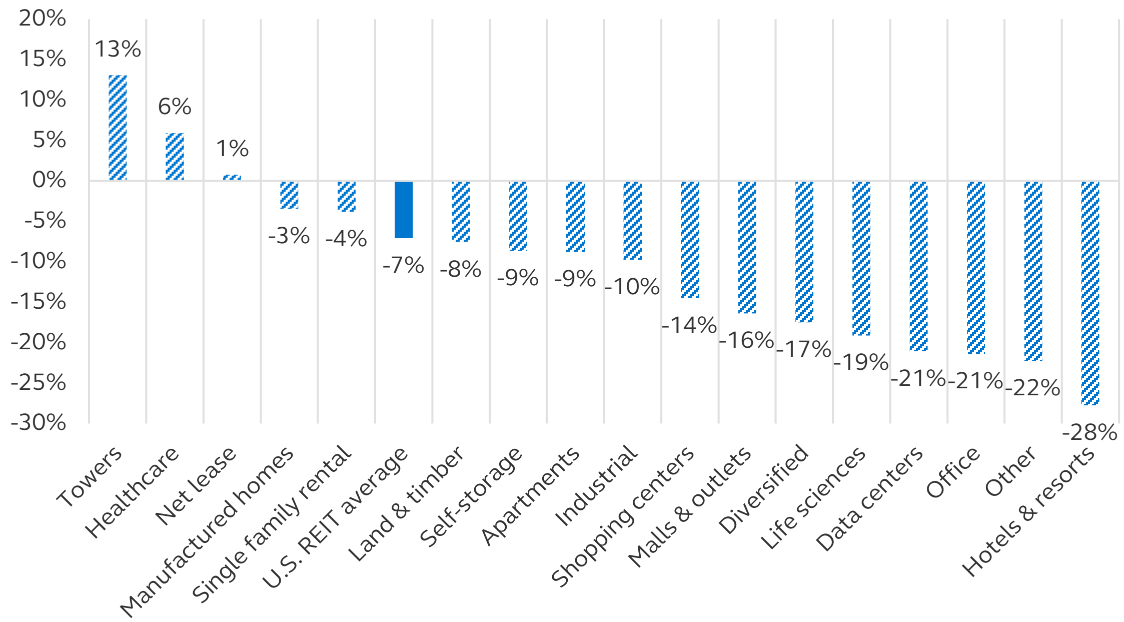
President Trump's ambitious policy actions aimed at reshaping the U.S. economic landscape and foreign policy have generated greater uncertainty in markets and the economic outlook.

Defensive areas of the equity market are outperforming, including listed REITs, and U.S. markets have lagged non-U.S. markets. For U.S. REITs, this is the best relative start versus the S&P since 2008 and the 4th best since 1999. A similar story is evident within REIT markets as defensive property sectors outperform cyclical sectors and global REIT indices outperform the U.S.

Listed REITs take the lead year to date as markets turned risk-off



Within U.S. listed REITs, defensive sectors are outperforming cyclical stocks



As of 7 April 2025. Source: FactSet. FTSE NAREIT All Equity REITs (U.S. REITs), S&P 500 (U.S. equities), FTSE EPRA NAREIT Developed (global REITs), and MSCI World (global equities) Indices. Returns in USD. Past performance is not a reliable indicator of future performance and should not be relied upon to make investment decisions. Index performance information reflects no deduction for fees, expenses, or taxes. Indices are unmanaged and individuals cannot invest directly in an index. Does not represent any investment strategy.

REASON 2

REITs are relatively insulated from tariffs and other Trump policies

Issue	Risks and impact on listed REITs
Tariffs	No direct impact on listed REIT companies. Indirect impacts are uncertain as Trump's tariff policy can change quickly, but the worst potential outcome is tariff-induced inflation will create U.S. stagflation. Rising yields and slowing growth would be a headwind for real estate unless the Fed can cut rates to support employment. If a moderate economic recession occurs or the U.S. can skirt one, REITs likely outperform equities given tailwinds from easing monetary conditions and defensive market rotation and may even deliver positive absolute returns. • **Industrial** REITs may see the largest indirect effects, particularly assets located in U.S. port markets with significant Chinese exposure. Lower trade volume could reduce tenant demand in these markets. • **Retail** faces risks primarily from potential shortages, though most major operators have taken proactive measures to maintain inventory levels. The greater concern is consumer inflation, which will weight on overall spending levels and retailer health. • **Data centers** rely on critical components such as servers, networking equipment and semiconductors sourced from North Asia which is at the heart of the tariffs. While semiconductors are exempt from tariffs, the other components are not. This could slow cloud and AI investments. • **Construction costs** rising from tariffs on Canadian aluminum, steel, and lumber could pose a significant challenge to new construction. U.S. REITs derive only a small percentage of earnings from new development and the impact of lower supply across real estate markets would be a positive for REITs.
Foreign Policy	Risks or impacts are likely indirect to REITs. U.S. capital markets and the U.S. dollar could be negatively impacted by any derisking from America that other countries might take. Increases in fiscal stimulus packages or new trade agreements from other countries could be a positive tailwind for non-U.S. REITs.
DOGE	REIT exposure to federal government leases is relatively low. A return to office mandate for federal employees is likely a net positive. The larger risk is to the office and apartment markets where there are job losses and cuts to federal contracts and grants for other industries.
Immigration	Risks or impacts from labor shortages in industries that support real estate (construction, property maintenance, etc.) are still uncertain.
Deregulation & taxes	Currently, we are not aware of any new policies on regulations or taxes that pose a risk to REITs. Any impact is likely to be an indirect positive as markets respond favorably to measures to stimulate economic growth via tax cuts or deregulation. Banking deregulation for instance could help bolster the supply of credit to the REIT sector.

REASON 3

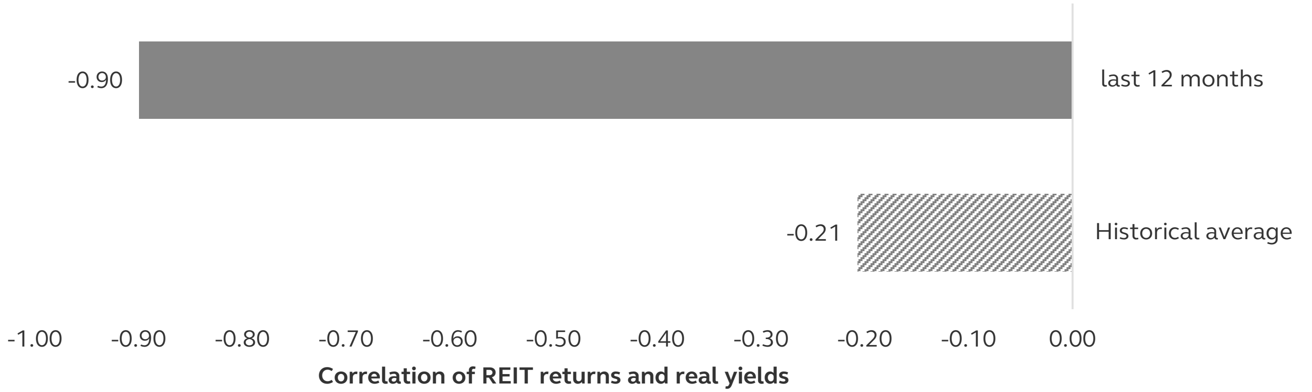
What will drive REIT returns? The answer is often real yields

The recipe that makes REITs a compelling investment today already contains two important ingredients – cheap valuations and positive fundamentals. A third and often the most important ingredient has been missing the past few years – accommodative interest rates. Yields have been volatile from one quarter to the next and moving higher year-after-year. The result has been a generational repricing of listed REITs and real estate since 2022.

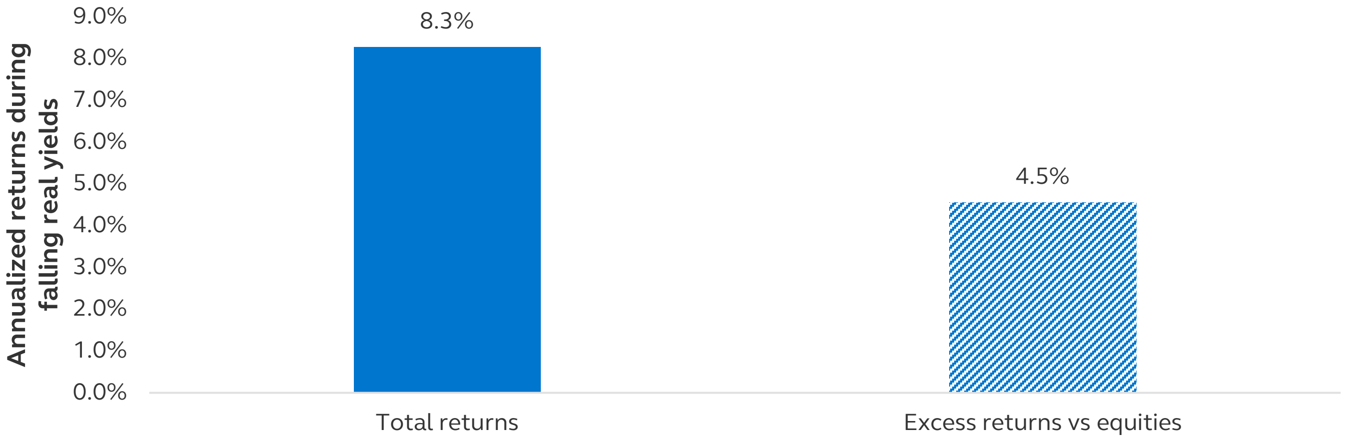
Trends have shifted year-to-date, and yields have come back down, along with a growing concerns of slowing growth for the economy. Lower long-term yields are a positive for this longer duration, rate sensitive asset class and real yields importantly drive pricing for property.

Today, the relationship of REIT returns and changes in real yields is at extreme levels with a -0.9 correlation. That's a problem when yields are rising, but a decline going forward would be welcomed relief for REIT stocks as it has been historically.

Current REIT sensitivity to changes in real yields (large inverse correlation) is meaningfully higher than long term averages



Historically, when real yields have fallen, U.S. REITS have had strong total and excess returns relative to equities



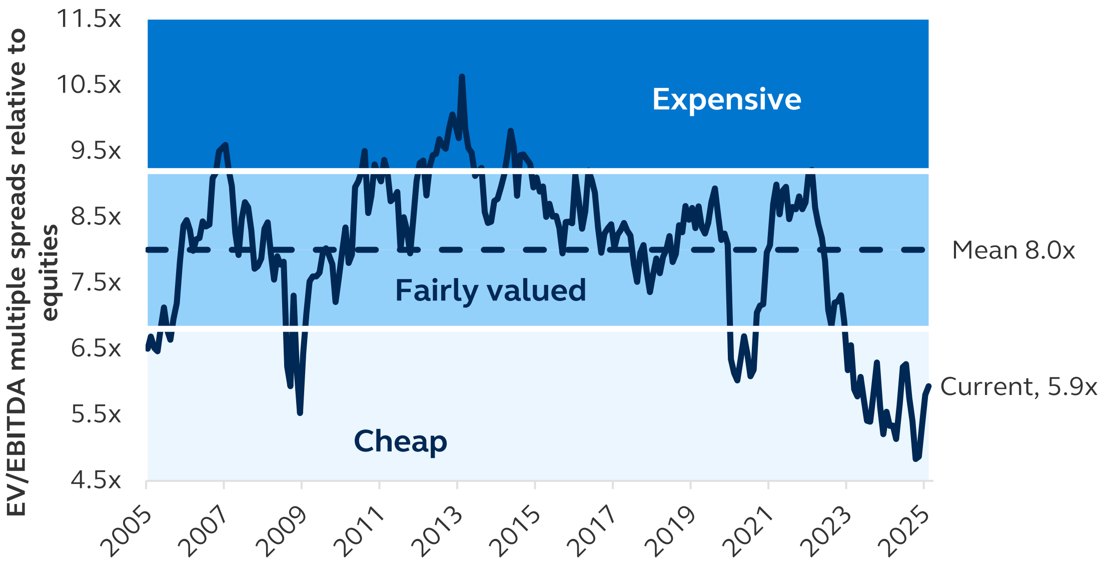
As of 31 March 2025. Source: FactSet. Real yields represented by the US 10-year TIPS yield. Returns data is showing FTSE NAREIT All Equity REITs total returns and excess returns over the S&P 500 during the last 7 periods of falling real yields (a sustained decrease of at least 75 bps). The rolling 12-month correlation average is since the earliest available real yields data (31 January 1997). Past performance does not guarantee future results. Indices are unmanaged and do not take into account fees, expenses, and transaction costs and it is not possible to invest in an index.

REASON 4

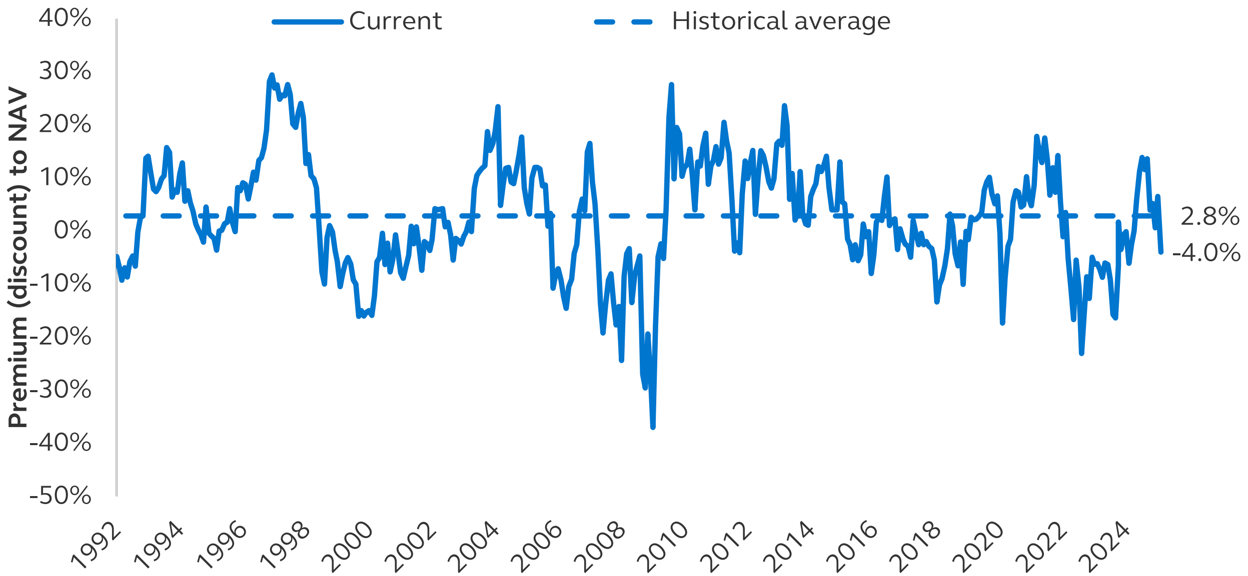
Listed REITs are offering a compelling entry point for long-term investors

Listed REITs are cheap relative to equities. That's been true for years now as superior Mag 7 earnings growth and rising real yields have mattered more than valuation. The depressed valuations of REITs even before the start of tariff induced market volatility may provide some stability to stock prices in the near term. But more importantly, it gives us conviction in today's entry point as an avenue for achieving attractive, long-term returns versus equities. Principal's Long-term Capital Market Assumptions report cites, U.S. and global REITs are expected to deliver the highest returns the next 10 years amongst all equity indices with expensive valuations a drag on broader equity market returns.[1] REIT valuations versus private real estate screen attractive too, with REIT stock prices now trading at a discount to Net Asset Value (NAV) estimates.

Listed global REITs are trading near historically cheap relative valuations to equities



Listed U.S. REITs are trading at discounts to their long-term average Price to Net Asset value spreads



[1]10-yr Expected Annual Geometric Returns for FTSE NAREIT US REITs is 9.1% and FTSE EPRA/NAREIT Developed Index is 8.4% as of 31 December 2024.

Left chart: As of 7 April 2025. Source: FactSet. Enterprise Value (EV) to EBITDA price multiples are used to measure valuations. The spread plotted is the EV/EBITDA of the FTSE EPRA/NAREIT Developed index minus the EV/EBITDA of the MSCI World index. Expensive and cheap valuations are represented by spreads higher or lower than one standard deviation from the mean, respectively. Fair value is represented by valuations between one standard deviation from the mean. The average is since 28 February 2005. Right chart: As of 7 April 2025. Source: FactSet. This chart illustrates the weighted average Price/Net Asset Value of the stocks in MSCI U.S. REIT Index. The average is since 31 December 1992.

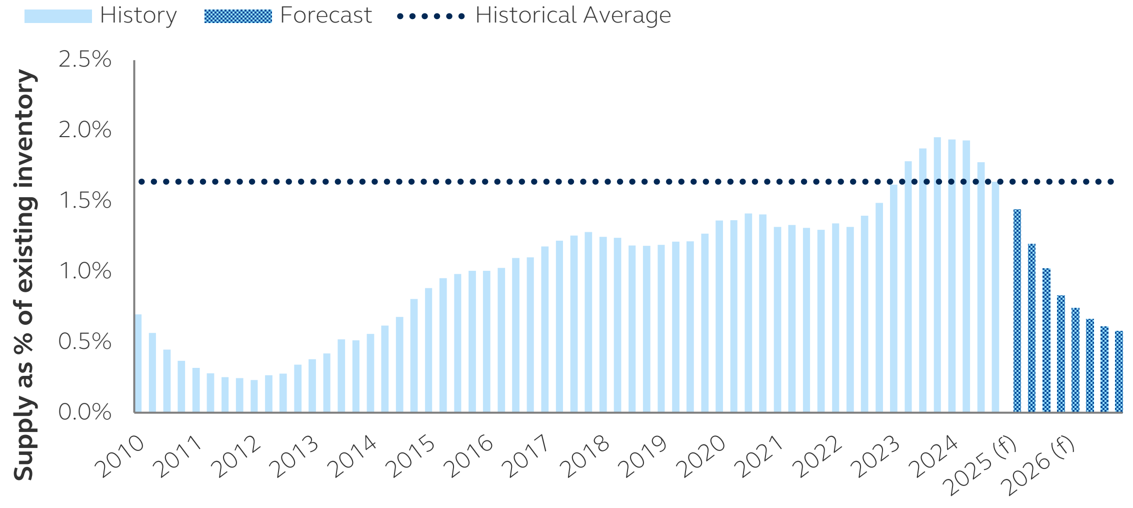
Past performance is not a reliable indicator of future return. Index performance information reflects no deduction for fees, expenses, or taxes. Indices are unmanaged and individuals cannot invest directly in an index. Does not represent any investment strategy.

REASON 5

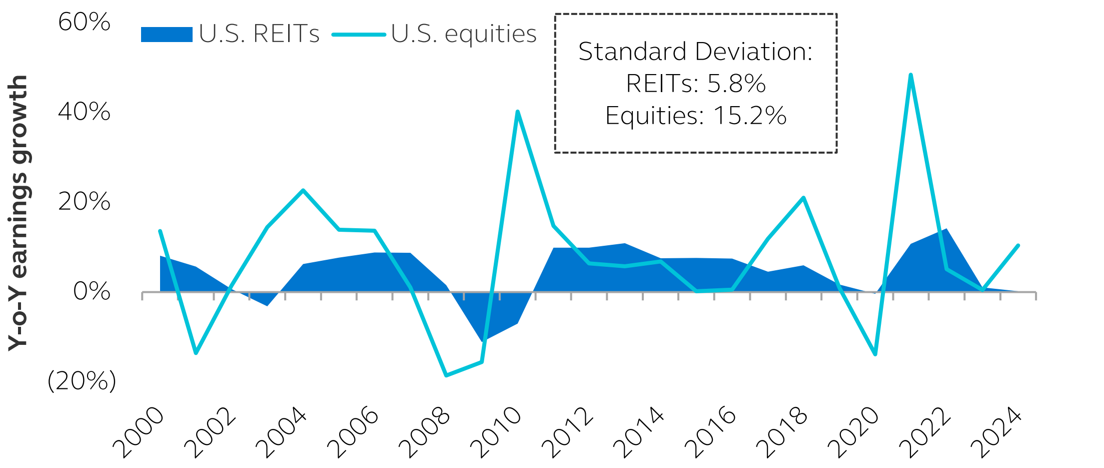
Company fundamentals are expected to remain steady

With a macro backdrop starting to wobble, it's important realize the steady, durable earnings that REITs offer. REIT earnings have some tailwinds building with new supply starting to come down after construction starts cooled the past two years. We also expect commercial real estate transaction activity to pick up in 2025 provided capital markets hold up. Many REITs, especially those trading at premium to NAVs, enjoy the advantage of both accessible and relatively attractive priced debt and equity capital. We expect this trend to continue in the year ahead, putting listed REITs in a good position to create long term value for shareholders. This is especially true given 2025 should be a good vintage to buy real estate for the next cycle, in our opinion.

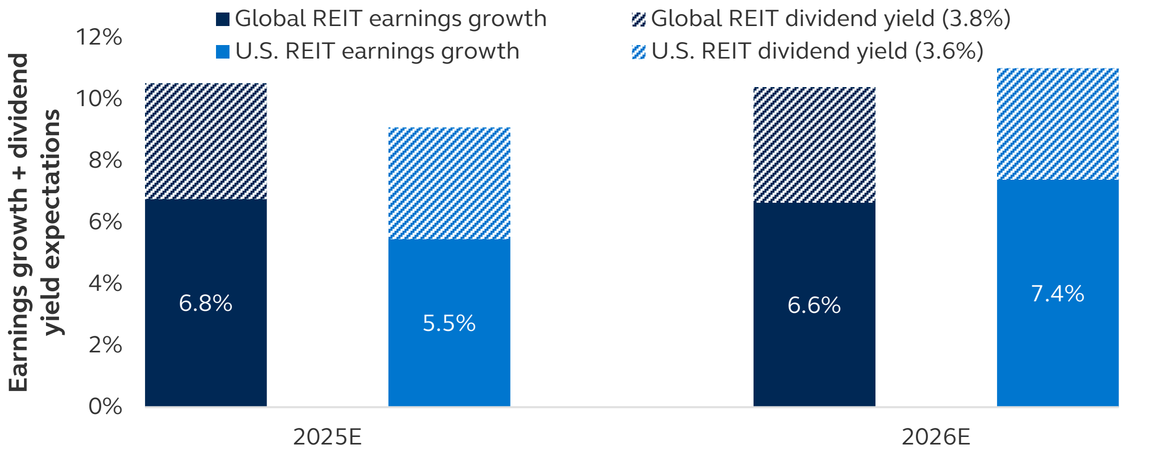
The supply of new real estate buildings has peaked and trending lower, a tailwind for future earnings growth[1]



REIT earnings are less volatile, making it more durable when growth slows



Dividend yields plus expected earnings growth provides some resiliency to future potential returns of REITs



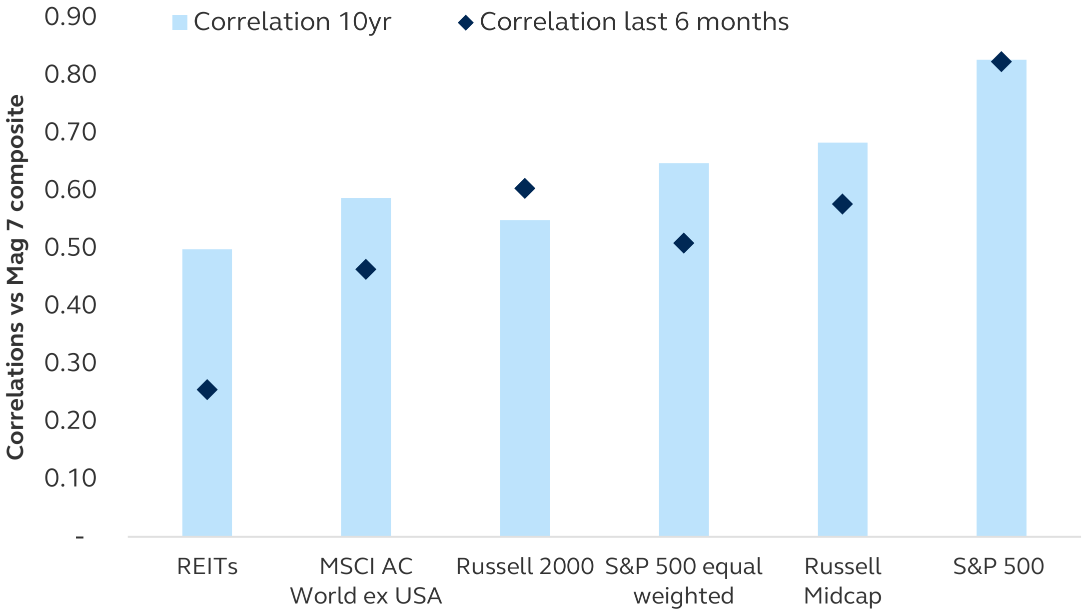
As of 31 December 2024. Source: FactSet, Principal Asset Management. Earnings growth from the FTSE NAREIT All Equity REITs, S&P 500, and FTSE EPRA NAREIT Developed indices. Dividend yield reflects values from 31 December 2024.
[1]Source: Principal Real Estate, December 2024. Reflects total completions for multifamily, industrial, office, and retail. This reflects our views on relative opportunities over a 12-month horizon. It is not intended to be, nor should it be relied upon in any way as a forecast or guarantee of future events regarding particular investments or the markets in general.

REASON 6

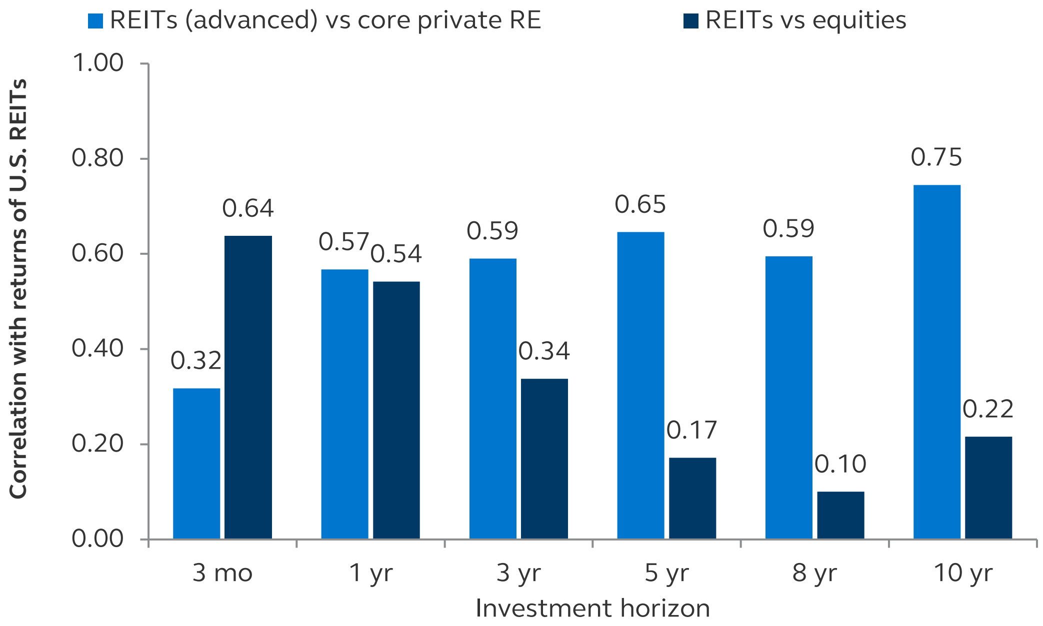
Diversifying with REITs remains beneficial and is increasingly relevant today

In an environment where equity markets are dominated by a handful of expensive, high-growth stocks (the Mag 7), diversifying sources of risk in an investor portfolio is more important than ever. REITs provide a compelling alternative with low correlations to these mega-cap tech names, offering a differentiated return profile. Longer duration REITs can also serve as a valuable counterbalance against other stocks with greater economic sensitivity, as REIT earnings are tied to contractual longer-term leases and property fundamentals. Over longer-term investment horizons, REITs behave more like private real estate, reinforcing their role as a portfolio diversifier. As investment horizons lengthen, REIT performance has historically decoupled from public equities, aligning more closely with the fundamental value of the properties they own. This makes REITs an attractive option for investors seeking both liquidity and the stability of real assets in a portfolio.

Defensive REITs offer low correlations to the over-concentrated Mag 7



Long-term, REITs behave more like real estate and less like stocks



Left chart: As of 31 March 2025. Source: FactSet. Right chart: As of 31 December 2024. Source: Analysis of data from FTSE NAREIT All Equity REITs Index, NCREIF National Property Index, and S&P 500 Index from 1/1/1993-12/31/2024. Public REIT returns are lagged 4 quarters relative to private real estate returns to adjust for the return lag private equity funds experience due to less frequent measurement compared to public markets.

Frequently asked question:

Is it time for an allocation to global or U.S. REITs?

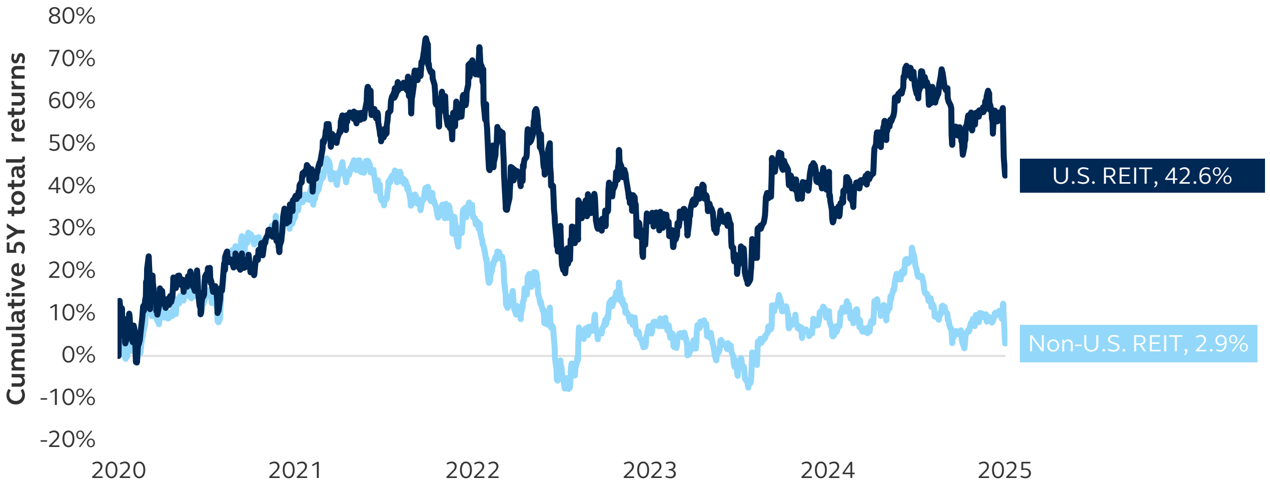
A decade of U.S. exceptionalism and strong USD helped fuel large outperformance of U.S. REITs over global REITs the past five and 10 years. The investment landscape is perhaps shifting with trade wars and 'America First' foreign policy. What was once a straightforward U.S.-centric story is now evolving into a more balanced, global opportunity set – and while U.S. exceptionalism likely reigns supreme, Europe and China are increasingly taking a prominent role.

The U.S. REIT market will continue to be beneficiaries of the large and concentrated exposure to non-traditional sectors with durable secular growth – seniors housing, wireless towers, single-family rental, etc. A potential new era of a weakening USD and tariffs won't directly impact the earnings of U.S. REITs, but a U.S. economic recession is a concern.

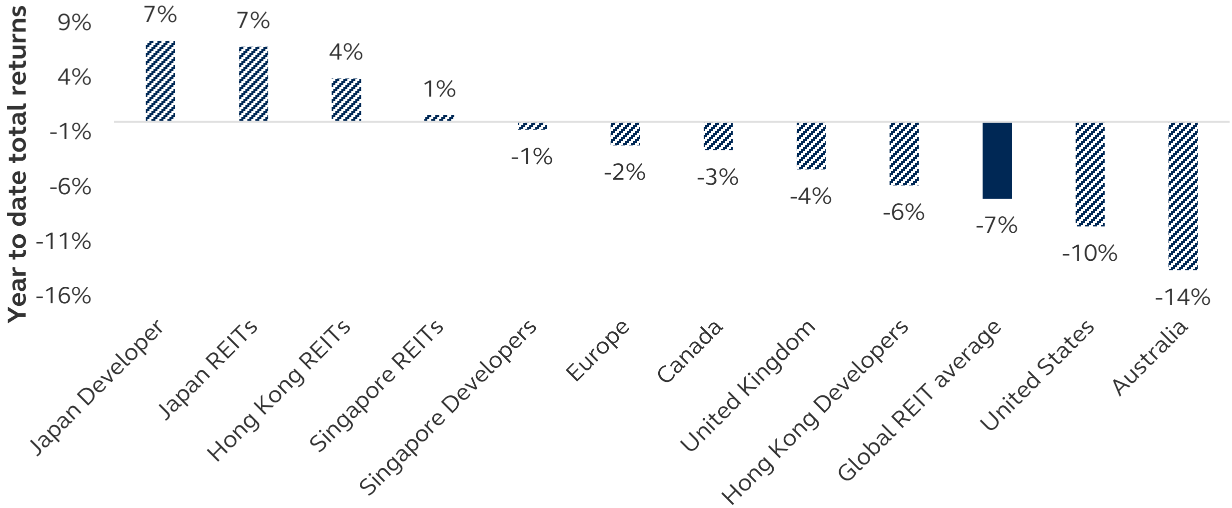
However, for U.S. based investors a global REIT allocation could help diversify U.S. recession risks and take advantage of a weaker USD. Potential fiscal stimulus packages introduced by Europe and other countries could drive growth and investment in real estate in those local markets. Furthermore, any de-risking of America by foreign investors would drive capital flows into countries outside the U.S. Trade war escalation and economic fallout is a risk.

While the U.S. will always play a prominent role in investor REITs portfolios, the shifting investment landscape may lead to a period of new leadership in REIT markets.

A combination of a rising US dollar, strong U.S. economy, and geopolitical effects have caused U.S. REITs to widely outperform non-U.S. REITs the last 5 years



YTD non-U.S. REIT markets are outperforming by a wide margin relative to the U.S.



As of 7 April 2025. Source: FactSet. FTSE NAREIT All Equity REITs (U.S. REITs), FTSE EPRA NAREIT Developed x-US (non-U.S. REITs), and FTSE EPRA NAREIT Developed (global REITs) Indices. Returns in USD. Past performance is not a reliable indicator of future performance and should not be relied upon to make investment decisions. Index performance information reflects no deduction for fees, expenses, or taxes. Indices are unmanaged and individuals cannot invest directly in an index. Does not represent any investment strategy.

Important information

Risk Considerations

Investing involves risk, including possible loss of principal. Real estate investment options are subject to some risks inherent in real estate and real estate investment trusts (REITs), such as risks associated with general and local economic conditions. Investing in REITs involves special risks, including interest rate fluctuation, credit risks, and liquidity risks, including interest conditions on real estate values and occupancy rates.

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