Euro Area Market Monitor: Q1 2020

Alpha Real Capital

Summary

Inflation

- Euro Area HICP inflation declined in Q1 from 1.3% y/y in December 2019 to 0.7% y/y in March 2020, driven mainly by lower energy prices reflecting lower oil prices and deteriorating demand as a result of Covid-19. Food inflation however continued to strengthen, most likely boosted by households' stockpiling.
- Looking forward, Euro Area Q2 2020 CPI y/y is expected to fall off the back of a significant global slowdown, with 2020 y/y CPI expected to be 0.2%. This decline is evident in the EURO HICP forward curves.

Credit spreads

- Investment grade credit spreads have widened significantly in response to the coronavirus and the subsequent weakening of the economy. The increase in credit spreads comes despite significant attempts by central banks to increase liquidity.

Bond yields

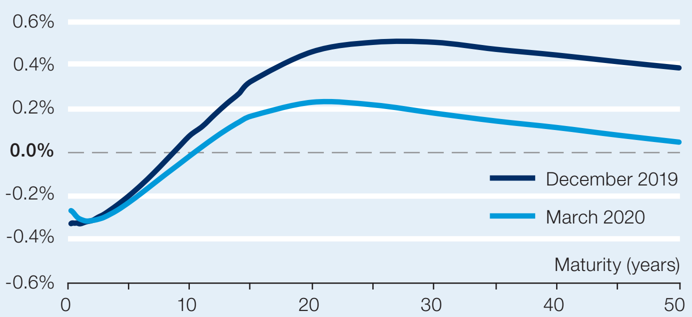
- Bond yields have fallen across the Eurozone following the decision of the European Central Bank's (ECB) quantitative easing scheme to buy €750bn of bonds in response to the economic impact of the coronavirus.
- Falling yields have reduced the strain for European government borrowing and this has sent a clear message to the market that the ECB is willing to support borrowing. The German Bund curve remains almost entirely negative yielding.
- Markets are watching whether a common debt instrument - a 'coronabond'- will be issued by the ECB on the back of a request by members of the EA. The 'frugal four'; Germany, Netherlands, Austria and Finland, have traditionally opposed debt mutualisation for moral hazard reasons.
- Strong demand for safe-haven investments is expected to remain the fundamental driver for fixed income markets in Q2 2020.

Macro picture

EA GDP (y/y) Q4 2019	1.3%
ECB marginal lending rate	0.25%
EA March HICP Inflation	0.7%
Netherlands CPI (y/y)	1.4%
Germany CPI (y/y)	1.4%
Ireland CPI (y/y)	1.1%

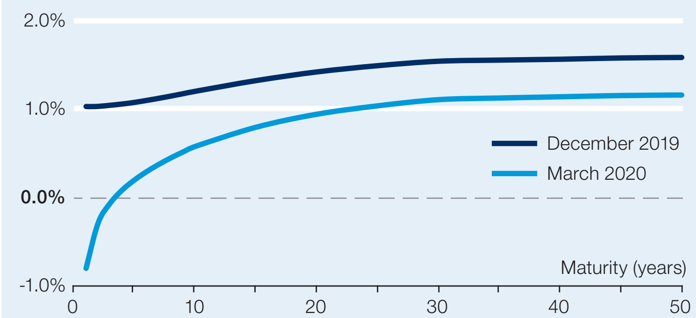
Sources: Eurostat, ONS, Barcap, Reuters, FT.com, March 2020 or latest published figures

EURO nominal swap yields forward curve



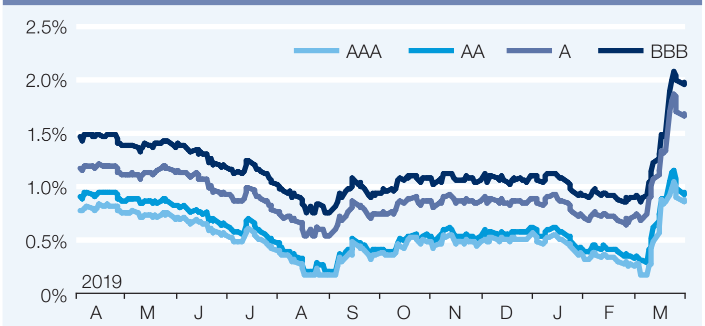
Source: Barcap – December 2019 and March 2020

EURO HICP swap rate forward curve



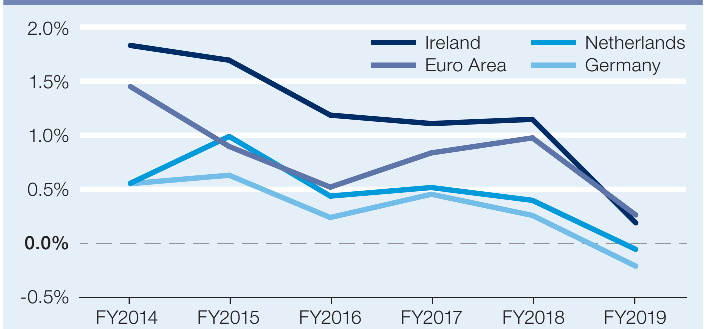
Source: Barcap – December 2019 and March 2020

EURO historic 10-year credit spreads



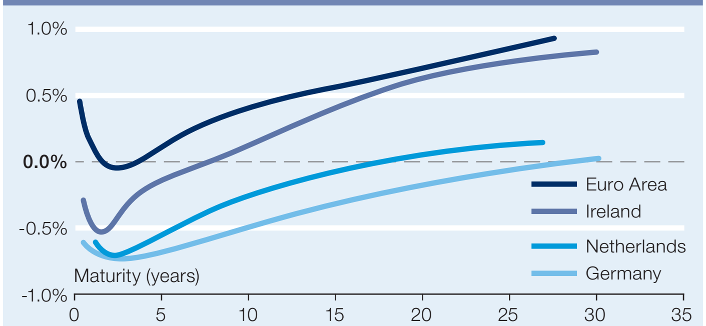
Source: S&P Global, March 2020

Historic 10 year nominal Government bond yields



Source: S&P Global – March 2020

Nominal bond yield forward curves



Source: Barcap – March 2020

Economic indicators

Avg. annualised GDP rate	1-year	3-year	5-year	10-year
Germany	0.60%	1.53%	1.70%	1.26%
Ireland	1.70%	8.15%	11.30%*	5.24%
Netherlands	1.90%	2.75%	2.45%	0.92%
Euro Area	1.90%	2.20%	2.10%	0.80%
Avg. annualised CPI	**Q1 2020**	**1-year**	**3-year**	**5-year**
Germany	1.40%	1.50%	1.60%	1.20%
Ireland	0.70%	1.00%	0.60%	0.40%
Netherlands	1.40%	2.40%	1.90%	1.40%
Euro Area	1.60%	1.40%	1.60%	1.10%

* Ireland had a 26.3% spike in GDP in 2015 due to revised figures taking into consideration foreign investment. GDP figures are based on Q4 2019 data as Q1 2020 data not released. Source: Eurostat, S&P Global – March 2020

European pension funds reveal primary features in long income property investment strategies

Research[1] from Alpha Real Capital LLP ('Alpha'), the specialist manager of long income assets, reveals what institutional pension fund investors value most[2] from Long Income Property[3]. The latest research was prompted by findings from December 2019[4], which uncovered 84% of professional investors believe the level of investment in long income property from pension funds will rise over the next two years, with one in five (20%) anticipating a 'dramatic' increase.

Alpha's new research, conducted with 125 institutional pension fund investors across the UK, Ireland and Continental Europe[5] found those surveyed value risk management (24.5%) most in a long income manager, followed by performance track record (22.4%), competitive fees (21.3%) and origination capability (20.5%).

In total, 25 institutional professional investors were interviewed in each of the five countries, with the respondents demonstrating several marked differences in the responses from each country, as well as some counties indicating some common values.

The table below summarises what investors from each country believed is the most important factor when assessing the attractiveness of a long income property strategy:

Country	Factor	% selected as 'very important'
Germany	Expected long term performance	68%
Ireland	Distribution yield	60%
Netherlands	Terminal value / re-letting risk	100%
Switzerland	Expected long term performance	72%
UK	Terminal value / re-letting risk & ESG	68%

In assessing the attractiveness of long income strategies, 68% of UK pension funds surveyed believe that ESG factors (relating to long lease property assets or managers) are 'very important', higher than the 'very important' scores for factors such as distribution yield, expected long term performance, and income security. Just 64% of German and Swiss respondents believe that 'income security' is at least 'somewhat important' in assessing the attractiveness of long income property. This is in contrast to the 100% score from UK and Dutch pension funds. Only 24% of German pension funds surveyed believe that terminal value / re-letting risk is a 'very important' factor, compared to 100% in the Netherlands and an average across all geographies of 54%.

In assessing the attractiveness of a long income property strategy, how important are the following factors?	Very Important	Somewhat important	Worth considering
Expected long term performance	66.4%	27.2%	6.4%
External macro factors such as inflation and interest rates	58.4%	36.0%	5.6%
Terminal value / re-letting risk	53.6%	39.2%	7.2%
Income security	52.0%	32.0%	16.0%
ESG	48.0%	42.4%	9.6%
Distribution yield	46.4%	51.2%	2.4%

Hugo James, Partner and Head of Long Income, Alpha Real Capital, said: "With increasing interest in long income property as an asset class, it is interesting to see the differing priorities of pension fund investors within each country. There is, however, a degree of commonality in valuing the importance of long-term returns with the need to understand the risks involved in investing in the asset class. Managers will need to demonstrate to their investors that they understand and can quantify these risks to provide confidence that expected returns will materialise for investors. At Alpha, our transaction rating processes are a key component of our investment strategy to mitigate risk, and we encourage investors to build their confidence in long income property and increase their exposure to this growing asset class. In relation to ESG factors, these are becoming increasingly important to our investors and we believe they must be a key part of the investment process when considering long income property assets."

Alpha Real Capital is well positioned to capitalise on the growing investment opportunity set and investor demand for long income property assets. In the last year we invested more than £1.1bn in long income assets across commercial ground rents, long lease property, social real estate and renewables on behalf of our funds and clients. Since, December 2017, the value of long income real estate assets in our funds has increased by 65% from £2.3bn to £3.8bn.

1 Alpha Real Capital commissioned the market research of 125 institutional investors who help manage pension funds. These pension funds ranged in size from £5bn, with 84% of respondents sized £300m-1bn.
2 Respondents voted for their top 3 factors.
3 Long income property is real estate let on long-dated, typically inflation-linked leases for between 15-200 years. It comes in several different structures including commercial ground rents, income strips (amortising) and other long lease property such as sale and leasebacks.
4 Alpha Real Capital commissioned the market research firm Pureprofile to interview 50 professional investors. They included institutional investors such as pension funds and insurers and real estate professional investors. The research was conducted in December 2019 – interviews were conducted online.
5 (Switzerland, Germany and The Netherlands).

White papers are available to download at **alpharealcapital.com/news**

Your contacts at Alpha Real Capital

Hugo James
Partner, Head of Long Income
+44 (0)207 391 4729 hugojames@alpharealcapital.com

Tom Benham
Director, Long Income
+44 (0)207 391 4731 thomasbenham@alpharealcapital.com

Scott Gardner
Partner, Institutional Capital
+44 (0)207 391 4723 scottgardner@alpharealcapital.com

Adam Hayes-Newington
Institutional Business Development
+44 (0)207 391 4561 adamhayes-newington@alpharealcapital.com

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For more information about Alpha Real Capital LLP, its funds and key personnel visit: www.alpharealcapital.com

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