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As asset values have staged a partial recovery from the recent market crisis, many institutional investors have begun to gradually and strategically sequence back into higher risk products in an effort to capture attractive returns over a long-term investment horizon.

As part of that rebalancing process, these investors have undertaken a review of the strategic case for various asset classes by reassessing key parameters such as correlations, liquidity and risk.

Given that backdrop, we believe that now is an opportune time to revisit the strategic case for real estate investment trusts (REITs) by presenting our latest thinking on these property-linked equity vehicles. It is our view that: (1) the strategic case for REITs remains, in large part, intact, and (2) in areas of particular concern, such as volatility and correlations, there is a compelling argument that the market will return to more “normal” levels. In many ways, REITs’ most redeeming quality is that they provide access to two distinct asset classes—real estate and equities—and thereby offer investors the potential for tapping into the “best of both worlds.”

Specifically, our strategic case for REITs is anchored in the following core attributes:

- We believe that REITs often act like a proxy for real estate investments over the long term, capturing many of the performance attributes of direct investments in property.
- Our analysis indicates that REITs may be more highly correlated to equities in the short term, potentially acting as a hedge against declining real estate values and also providing an indicator on the directionality of real estate value momentum.
- In our view, REIT volatility will decrease significantly over the next several years as REITs delever and yields return to a historical relationship of 60% of total return, improving the risk return profile of the asset class.
- We are confident that REIT correlations with equity will move closer to historical norms over the next several years.
- And, finally, REITs are a publicly-traded, liquid investment that allows investors the opportunity to tactically re-allocate at inflection points in the real estate cycle.

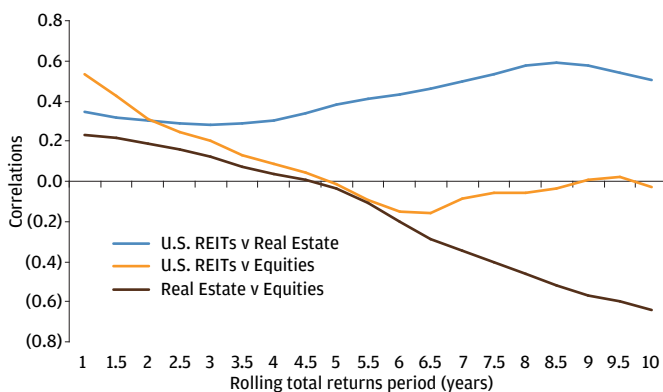
The Long-Term Case for REITs

Comparing returns

It is generally accepted that over a short-term horizon, total and price returns for REITs are more highly correlated with equity returns than direct real estate returns. We believe this makes REITs particularly attractive as a diversification play for real estate allocations in the short term, while providing real estate-like returns and, critically, cash flow yields over the long term.

Exhibit 1 underscores this point by illustrating total returns over the history of the direct U.S. real estate index (1978-2009). While one-year and two-year rolling total returns for U.S. REITs are more highly correlated with equities than direct U.S. real estate investments, as the return period increases, the REITs returns become increasingly correlated to direct real estate returns, while correlations to equities move in the opposite direction, eventually becoming negative.

EXHIBIT 1: CORRELATIONS OF REIT, REAL ESTATE AND EQUITY RETURNS



Source: J.P. Morgan Asset Management, Morgan Stanley, NAREIT, NCREIF, Standard & Poor's.

To be sure, the correlation between direct real estate and equities develops along a similar trajectory, but is clearly and ultimately a negative correlation.¹

¹ It should be noted that these correlations are based on rolling returns as we believe the direction of the correlation is more relevant than the actual absolute levels.

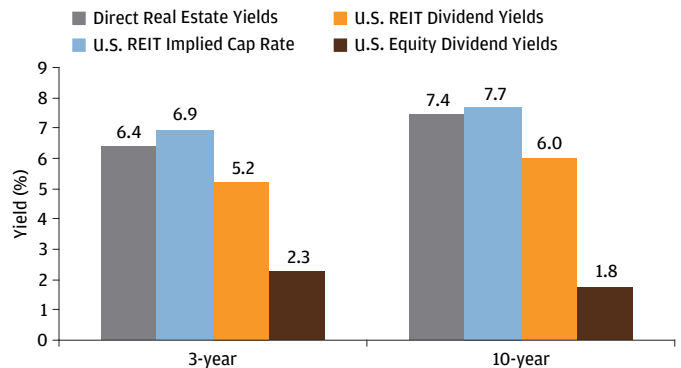
Comparing yields

Critical to the relationship between REITs and direct real estate investment is our contention that REITs provide yields that are more similar to those earned by investors in real property than in any other equity investment.

As illustrated in **Exhibit 2**:

- Compared to the broader equity market, REIT dividend yields are much closer to the unlevered yield offered by direct real estate, particularly over a ten-year period or longer.²
- REITs' implied capitalization rate (ICR)—a measure that attempts to calculate the yield earned on a particular REIT's unlevered operating assets given the current pricing of the REIT equity—is surprisingly similar to unlevered yields from direct real estate.

EXHIBIT 2: REITS HAVE PROVIDED REAL ESTATE-LIKE YIELDS



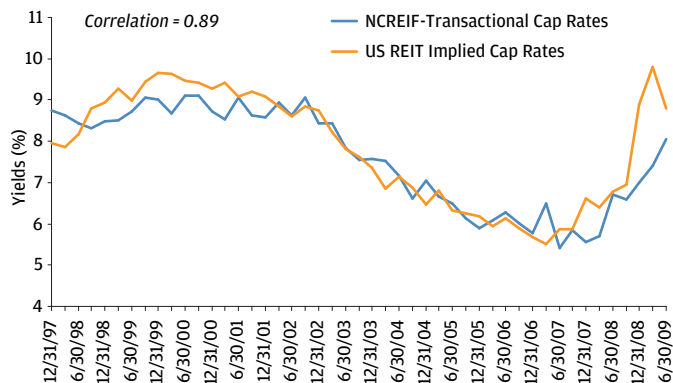
Source: J.P. Morgan Asset Management, NAREIT, NCREIF, Green Street Advisors, Standard & Poor's.

The ICR relationship is evidenced again in **Exhibit 3**, where the correlation between REITs and real estate yields, using the longest ICR series available, is a relatively high 0.89 ($r^2 = 0.80$).

Of course, this should not be surprising since REITs obtain a large proportion of their operating income from their property portfolios, a source of income that is highly correlated to that of direct real estate. Because REITs usually pay out, on average, approximately 85% of their adjusted funds from operations (AFFO) cash flow as dividends, the cash flow yield to investors has averaged just over two-thirds of total returns during the so-called Modern REITs Era (1992-2008).

² The sectors in the REITs index and NCREIF can differ so this analysis is not a perfect measure of relative valuation.

EXHIBIT 3: U.S. REIT IMPLIED CAP RATE VS. DIRECT REAL ESTATE



Source: J.P. Morgan Asset Management, NCREIF, Green Street Advisors Inc.

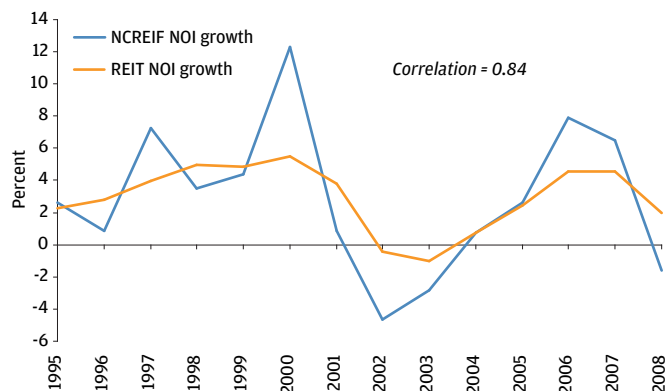
Providing further evidence of the long-term relationship between REITs and real estate yields, **Exhibit 4** shows historical same-store net operating income (NOI) growth for U.S. REITs compared to a similar measure for direct real estate. The correlation is, as expected, a notably strong 0.84 from 1995 through the end of 2008.

REITs as hedges

While direct real estate investors might expect REIT-linked stocks to continue to trade down as long as real estate values are declining, history shows us that when real estate values fall, shares of REITs initially tend to correct sharply, but then tend to trade upwards as they respond to other market events that are positive for equities as a whole.

Moving forward from that point, however, REIT share prices once again historically return to a positive relationship with direct real estate values. As real estate prices bottom out, as in

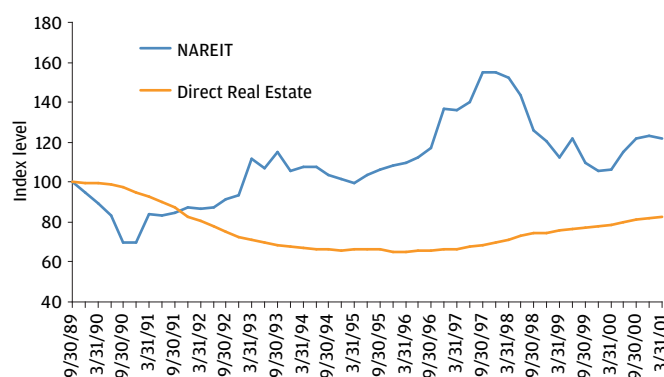
EXHIBIT 4: CORRELATION OF NOI FOR REITs, DIRECT REAL ESTATE



Source: J.P. Morgan Asset Management, Green Street Advisors, NCREIF.

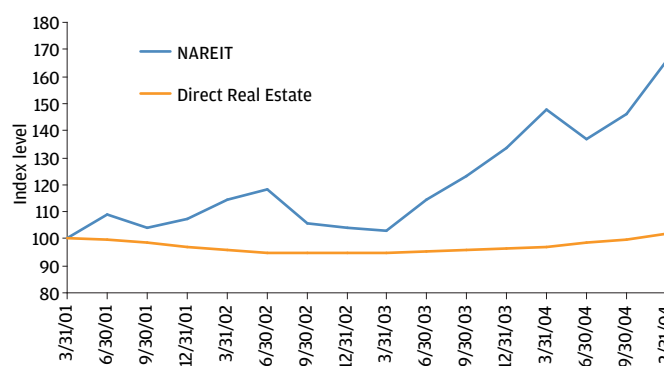
the early 1990s and in the 2001-2002 period, REITs continue to rally as they price in a recovery in the values and fundamentals of their underlying portfolios (see **Exhibit 5** and **Exhibit 6**). Moreover, it is noteworthy that the correlation of REITs values to direct real estate values has held up very strongly over even longer term periods. In fact, while the correlations in **Exhibit 1** between REITs and real estate *total* returns peak at 0.59 over the 8.5 year hold period, the correlation between *price* returns reaches 0.71 for the same hold period.

EXHIBIT 5: REIT RETURNS POSITIVE DESPITE REAL ESTATE SLIDE, 1989-2001



Source: J.P. Morgan Asset Management, NCREIF, NAREIT.

EXHIBIT 6: REIT RETURNS POSITIVE DESPITE REAL ESTATE SLIDE, 2001-2004



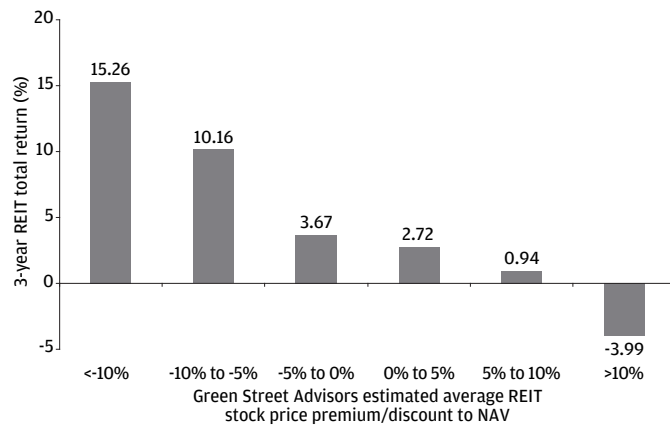
Source: J.P. Morgan Asset Management, NCREIF, NAREIT.

In further support of our view that REIT returns are closely linked to direct real estate valuations, research by the National Association of Real Estate Investment Trusts (NAREIT), using data from Green Street Advisors, Inc., shows that the Net Asset Value (NAV) valuation methodology—which is calculated by estimating the value of a REIT’s underlying direct property interests—also implies a convergence between REIT NAVs and

The Best of Both Worlds

real estate values. As **Exhibit 7** indicates, the greater the NAV discount, the higher the subsequent three-year returns tend to be. Thus, when REITs are trading at a discount to their NAVs, which is an estimate of fair value for their portfolios, these valuation metrics have historically provided a basis for driving performance back in line with actual real estate prices. Needless to say, the inverse is also true.

EXHIBIT 7: REIT NAV DISCOUNT RELATIONSHIP TO TOTAL RETURN (1990Q1-2009Q2)



Source: NAREIT, Green Street Advisors.

Addressing the Short-Term Case Against REITs

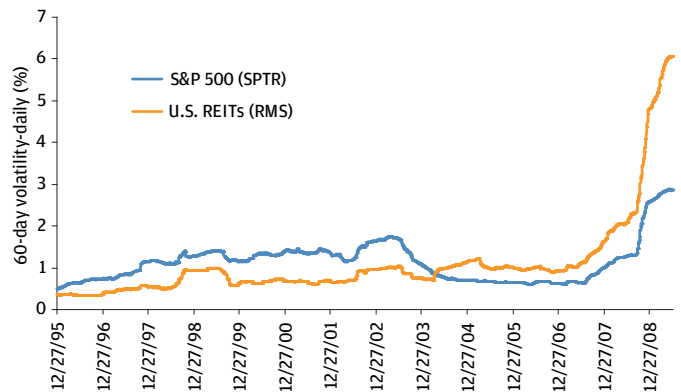
The elevated volatility of REITs, especially when compared to the S&P 500 Index, is typically a main topic of concern in any discussion about REITs. In fact, **Exhibit 8** shows that the volatility of REIT total returns (250-day window) has long been lower than that of total returns for the S&P 500, offering superior risk-adjusted equity-like returns that are anchored by a stabilizing yield.

However, since roughly mid-2004, that relationship has been turned on its head, with REIT volatility failing to ease while S&P 500 volatility has decreased significantly. The questions we will try to address next are: (1) why that happened, and (2) given those causes, are there reasons to believe REIT volatility can subside?

Cheap risk = riskier REITs

It is now common knowledge that an asset bubble earlier this decade buoyed prices of equity and real assets to unsustainable levels. Excess liquidity also impacted the commercial and REIT debt markets as the profusion of commercial mortgage-

EXHIBIT 8: U.S. REIT VOLATILITY VS S&P 500 (250 DAY WINDOW)



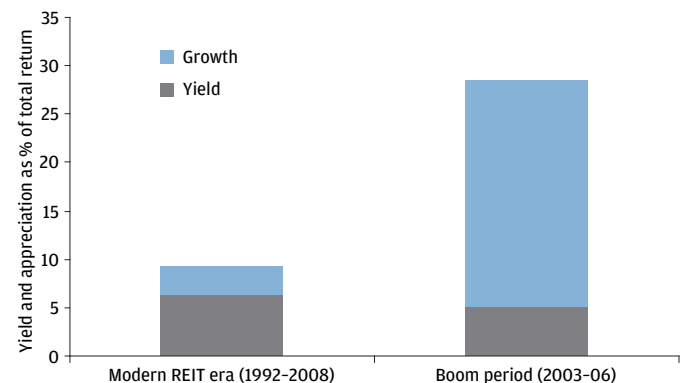
Source: J.P. Morgan Asset Management, MSCI, Standard & Poor's.

backed securities (CMBS) and lower risk premiums on unsecured REITs debt dramatically brought down borrowing costs. That phenomenon, in turn, has pulled down expected IRRs and current yields (i.e. capitalization rates) from real estate-linked investments.

The end result was an aggressive upward repricing of direct real estate with valuations soaring to record levels. As shown earlier in **Exhibit 3**, REIT cap rates are highly correlated to real estate yields, and those fell from 9.1% in 3Q02 to a trough of 5.4% in 2Q07. As REIT values skyrocketed, dividend yields fell to their lowest levels in the history of the NAREIT Equity REIT Index dating back to its inception in 1972.

This unprecedented tide of excess liquidity warped the REIT market in two significant ways. First, as shown in **Exhibit 9**, the typical relationship of REIT dividend yields to total return, with the yield accounting for just over two thirds of total

EXHIBIT 9: U.S. REIT TOTAL RETURN BREAKDOWN—GROWTH AND YIELD



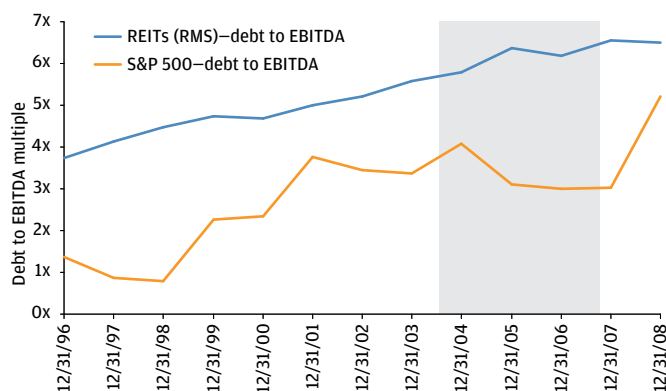
Source: J.P. Morgan Asset Management, NAREIT.

return over the Modern REITs Era (1992–2008), had flipped upside down. Yields accounted for only 18% of the average cumulative annual total return during this historic period of outsized REIT returns between 2003 and 2006.

Secondly, with escalating real estate values making it difficult to find accretive property acquisitions, and with NOI from REIT property portfolios still suffering from the 2001 recession, REIT management sought out cheap capital and other means of generating cash flow growth. This trend produced the following structural shifts in the REIT business model: (1) many REITs levered up with cheap debt financing, and (2) REIT management teams increasingly looked to “other income” to supplement organic growth in their portfolios.

In **Exhibit 10**, it is apparent just how much REITs increased the debt loads borne by their companies. We believe it is noteworthy how that compares to the overall S&P 500 index, which remained consistently more lowly levered relative to REITs over the entire period. Even as the S&P 500 showed a demonstrable improvement in this measure over the 2004–2007 period, REITs continued to lever up like other real estate investors. It must be noted that the debt-to-EBITDA multiples for the S&P 500 jumped in late 2008 as financial companies’ EBITDA dropped dramatically, due to the credit crisis.

EXHIBIT 10: REITS MORE LEVERED THAN S&P 500, 2004–2007



Source: J.P. Morgan Asset Management, FactSet, S&P.

As mentioned above, REIT management teams started to focus on generating other forms of income not related to the direct operations of their investment portfolios (e.g. leasing space and collecting rents). The tactics differed from REIT to REIT, but generally included (1) *merchant building* involving the development of properties for sale (any capital gains were added to funds from operations [FFO]), and (2) *funds management*

A MATTER OF METRICS: DEBT-TO-GAV

We have deliberately used the debt/EBITDA multiple measure because we believe it most accurately reflects REIT leverage ratios and their ability to repay debt. But many REIT analysts and management often look at the ratio of debt to the value of the enterprise, a measure called the debt-to-gross asset value (Debt/GAV). This metric is largely driven by the value of the properties and land held by a REIT and is comparable to the loan-to-value (LTV) measurement of a property.

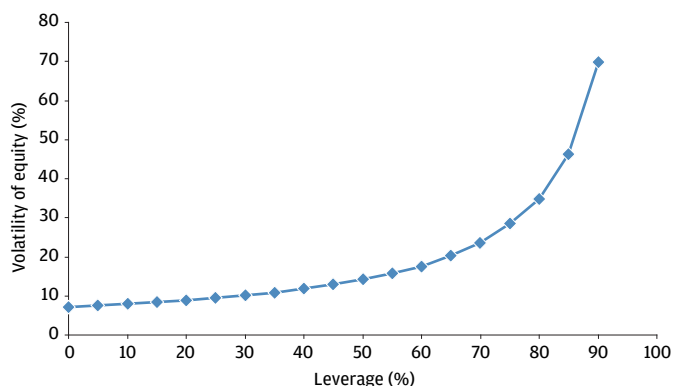
For example, assuming a given REIT has a 40% debt-to-GAV ratio (a rate that had approximated the long-term REIT historical average prior to the recent crisis), or \$40 of debt on a portfolio worth \$100, then if the value of the portfolio goes up by 25% to \$125, the REIT can refinance with the same LTV (40%) but end up with a mortgage of \$50. Given this scenario, the REIT not only maintains the same LTV, but also can pay off the old \$40 mortgage and keep \$10 for other non-core activities.

That type of proposition proved too tempting for many REIT management teams to resist. However, since a REIT’s EBITDA would not increase under that scenario, the REIT would be considered to have levered up from a strictly debt/EBITDA definition.

whereby REITs create funds with joint venture partners, typically institutions with more cost-competitive non-taxable equity capital and earn fees to manage the JV portfolios. While the level of adoption of these tactics differed from sector to sector, the equally weighted average of “other income” to FFO in three sectors for which data is available (strip malls, regional malls and industrial properties) increased from 12% in 2001 to 73% in 2008, according to Green Street Advisors, Inc.

As a consequence of these developments, REIT volatility (including the “volatility premium” to the S&P 500) increased to all time highs. For starters, REIT dividend yields have long been a stabilizing element for the asset class. But with the repricing of underlying REIT property portfolios, capital appreciation superseded other considerations, the relationship of yield to growth was inverted, and the volatility of the total return increased. What’s more, REITs levered up their equity, incurring higher volatility due to the additional risk posed by the layering on of that senior debt. In fact, **Exhibit 11** demonstrates the theoretical increases in equity volatility from adding leverage by using our own forward estimate for the volatility of NCREIF’s direct real estate total return index (NPI) adjusted for serial correlation. Assuming fixed, non-recourse debt (not marked-to-market), we estimate the volatility that would occur at different leverage levels. It should come as no surprise that the increases are steep, particularly after the 40% mark.

EXHIBIT 11: VOLATILITY OF EQUITY IMPLIED BY ADDING LEVERAGE



Source: J.P. Morgan Asset Management.

To understand what this meant in a practical sense for REITs in the recent downturn, it is important to consider the impact that falling real estate values have had on leverage ratios. As we explained earlier, due to the limits of the debt-to-GAV measure, REIT leverage levels remained relatively flat at 40% over much of the real estate bull market. This would imply no real increase in volatility, although if investors noted the increase in debt-to-EBITDA, an increase in volatility would be expected (and there is evidence, which we will share later, that this did happen). However, over 2007 and particularly into 2008, REIT investors started to mark down REIT portfolio values in anticipation of the decline in real estate values that is now underway. For example, given a starting debt-to-GAV of 40%, a 40% decline in real estate values (roughly the decline many REIT analysts expect over this cycle), would increase debt-to-GAV to 67%, with volatility almost doubling from 12% to 20%. If values fall 50%, then debt-to-GAV surges to 80% and implied volatility would hit 35%, three-fold the starting volatility levels. Incredibly, a handful of REITs have experienced these kinds of gyrations in valuation metrics over the past 12 months.

Furthermore, as REITs' "other income" increased as a share of FFO, the implied volatility of that cash flow also increased due to the fact that much of this new income depended on the ability to continue to attract investor capital, lease up and sell property. Needless to say, the prospects of transacting those activities dimmed substantially with the onset of the real estate market downturn.

We believe there is ample evidence that investors took notice of what was happening in the REITs space as the asset bubble neared its climax. Amid an unprecedented privatization boom which swept through the REITs sector from 2004 to 2007, pri-

vate equity investors saw an arbitrage opportunity to buy REIT companies at discounts to the value of their underlying real estate and sell off the properties in the hope of achieving significant capital gains.

Short interest

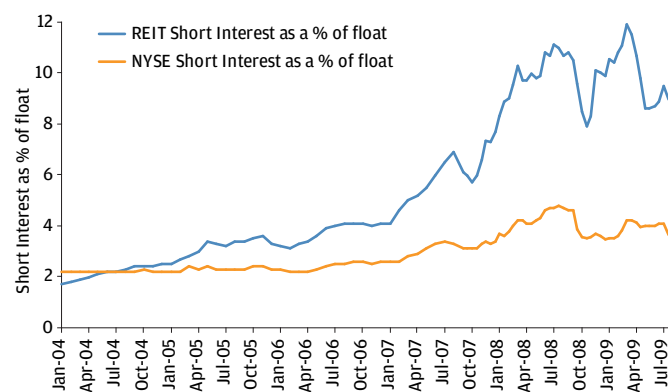
With increased attention from the alternatives community came greater shorting. Hedge funds began to target the sector in this regard as a result of the high leverage levels and growing evidence of an asset bubble. This exacerbated daily volatility as more speculative investors began to sell short or cover shorts in reaction to market overreach.

This rise in REIT short interest was dramatic, especially when compared to the overall NYSE (see **Exhibit 12**). Notably, short interest in REITs first exceeded that of the broader NYSE in August of 2004, which was roughly concurrent with the point when REIT rolling trailing daily volatility started to exceed that of the S&P 500. The differential only widened in the following years, peaking at 7.7% (11.9% for REIT short interest versus 4.2% for the NYSE as a whole) in March of 2009.

The role of ETFs

This trend did not escape the notice of exchange traded fund (ETF) providers, who began to devise increasingly specialized and controversial "leveraged" and "leveraged inverse" ETFs to capitalize on the increased volatility. That spawned a wave of leveraged REIT-focused ETFs that use swaps to deliver two or even three times the daily return (or inverse) of a given REIT

EXHIBIT 12: REIT SHORT INTEREST EXCEEDS THE NYSE AVERAGE



Source: J.P. Morgan Asset Management, J.P. Morgan Securities, Bloomberg, NYSE.

index. Additionally, there are multiple ETFs focused on stocks in financial services within the S&P 500, including 14 large-capitalization REITs in the financial services sector, as defined by the S&P 500 Index. As a result, trading in these ETFs has also impacted the REIT market.

Indeed, there is ample evidence that ETFs contribute to daily volatility as they concentrate their trading activity at the end of the day in order to maintain their leverage ratio.³ As such, they can drive exaggerated movements in the various REIT indices that they target. As of July 31, 2009, the assets held in dedicated real estate and financial services ETFs totaled \$20 billion. Given the scale of these products and the fact that their impact is magnified by the leveraged funds that also trade swaps as part of their hedging strategy, the share of REIT daily trading volume generated by these vehicles is by no means inconsiderable. However, regulators have begun to crack down on speculative trading in the ETF space, which may limit volatility in the REIT market going forward.⁴

Volatility Need Not Be Endemic

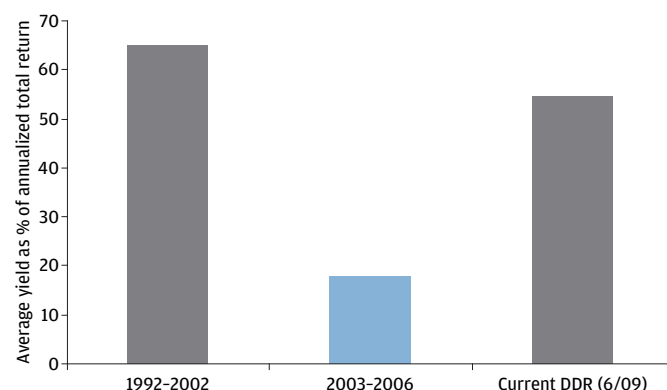
Needless to say, if the plausible causes of REIT volatility stated above can be rectified, then volatility would likely subside, perhaps even to levels close to or even below the S&P 500. Consider that:

1. REIT leverage has already come down from peak levels, decreasing 5%, or \$12 billion, from its all-time high (\$265 billion) between the end of 2008 and 2Q09. The REIT industry currently is engaged in a fierce debate about the role of leverage in real estate and the REIT business model. While there are no final conclusions yet, we believe a consensus is forming that REITs should not be levered to the extent that they have been and that REIT management should pay attention to both debt/GAV and debt/EBITDA measures. While the solution will undoubtedly differ from company to company, in our view the industry trend is moving towards deleveraging.
2. The skewed yield-to-total return relationship that plagued the REIT space over much of the 2000s has corrected. Despite the fact that multiple REITs have cut their dividends

³ "The ETFication of REITs," *European Investors*, June 2009; "The Dynamics of Leveraged and Inverse Exchange-Traded Funds," Minder Cheng and Ananth Madhavan, *Barclays Global Investors*, May 9, 2009.

⁴ The Financial Industry Regulatory Authority issued a notice on September 1, 2009 that increases margin requirements for investments in leveraged ETFs effective December 1.

EXHIBIT 13: REIT DIVIDEND YIELD AS A % OF TOTAL RETURN



Source: J.P. Morgan Asset Management, NAREIT.

and diluted those dividends further by issuing equity, the weighted average REIT yield at the end of July, 2009 stood at 4.9%, per NAREIT. As shown in **Exhibit 13**, the current yield accounts for about 55% of J.P. Morgan's 10.8% cap-weighted estimate of the Dividend Discount Return (essentially a forward IRR) for REITs as of June 30, 2009. That is close to the 65% share over the period from 1992-2002 (before the bull market). Given that we believe several large-capitalization REIT companies will eventually return to paying their dividends in cash rather than stock (currently stock dividends are excluded from calculations of the industry yield) the weighted average yield for the asset class may move upwards.

3. Some REIT management teams are already starting to simplify their business models, eliminating or excluding many of the more volatile types of "other income." Investors should expect to see merchant building gains, in particular,

WHAT DOES J.P. MORGAN EXPECT GOING FORWARD?

In the near-term, we expect REITs to continue to reduce leverage and simplify their business models, returning to their roots of leasing properties and paying out dividends from rental income. As dividend yields from recurring income return to levels approximating two-thirds of total return—in line with historical averages—volatility should fall. REITs have proven their ability to access capital markets and, as a result, we expect REITs to be part of the solution to the looming debt maturity problem in the commercial real estate market. We expect REITs to generate future earnings growth from accretive acquisitions of distressed properties.

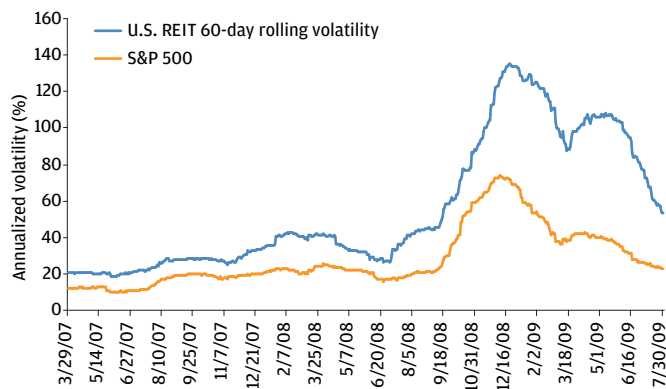
— *Kay Herr, Managing Director and Portfolio Manager for Global, International and U.S. REITs*

excluded from cash flow reporting, and a diminution (not elimination) of both merchant building and fund management activities.

- Growing resistance to the marketing of leveraged and inverse ETFs may curtail their profusion. Indeed, after the Financial Industry Regulatory Authority came out with a statement warning that the performance of these vehicles may deviate from the underlying indices in June, brokers such as UBS AG, Edward Jones and Ameriprise Financial Inc. all halted the marketing of leveraged ETFs to retail investors. Many other broker dealers are reviewing their policies.
- As we saw in **Exhibit 12**, while short interest in the REIT space remains elevated compared to the NYSE, it has been coming down in recent months. After dipping as low as 8.6% in May, it then climbed back to 9.5% in mid-July—still well below its 11.9% high in March of 2009.

Reassuringly, volatility is also coming down in the REITs space (**Exhibit 14**). It does, however, remain elevated compared to the S&P 500, but we believe that the factors mentioned above will, given enough time, have a real, sustained impact on volatility. Indeed, the REITs deleveraging process has just begun and could take several years to unfold as REITs issue equity to purchase properties for cash once real estate values bottom (in an attempt to temper shareholder dilution by creating additional value).

EXHIBIT 14: VOLATILITY FOR U.S. REITS REMAINS ELEVATED VS. S&P



Source: J.P. Morgan Asset Management, MSCI, Standard & Poor's.

Elevated Correlations Could Follow Volatility Downward

The real estate long cycle

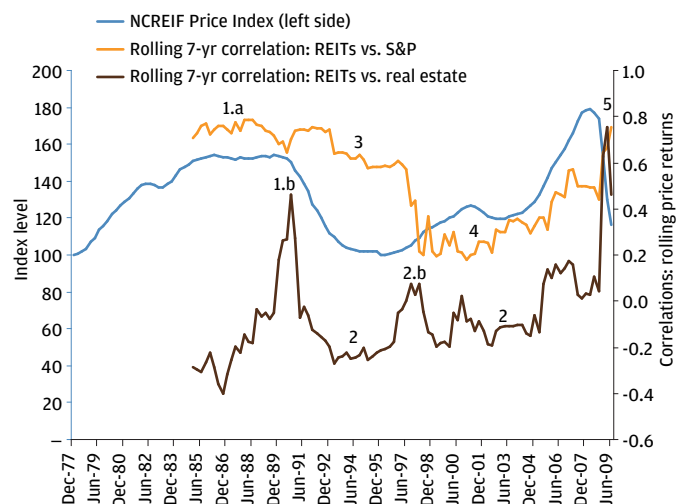
Researchers have identified a phenomenon called the real estate “long cycle,” which puts about 18 years between major dips in the real estate market. **Exhibit 15** shows that—measuring from the beginning of the sustained decline in 1990 through the beginning of the current decline—the current correction began 18.5 years after the previous real estate bear market.

As demonstrated in the first section of this paper, REITs tend to act and look like real estate over the long term. Thus, while REITs may act like equities in the short term, particularly at inflection points in equity cycles, they may also be impacted at key points by the longer-term real estate cycle, which in turn may impact the correlations between REITs and other asset classes.

An initial comparison of rolling seven-year correlations (we also looked at five-, and 10-year rolling correlations, which produced similar outcomes) among REITs, real estate and equities (S&P 500 Index) against the backdrop of the real estate long cycle generates what we believe to be interesting insights implying that correlations between REITs and the S&P 500 are (1) rightfully elevated at this point, and (2) headed for a sustained period of declining and then lower correlations.

We have used numerals in **Exhibit 15** to highlight some critical points demonstrating how a long-term REITs correlation cycle is linked to the real estate long cycle. At point (1.a), trailing

EXHIBIT 15: REITS INTERACTION WITH THE REAL ESTATE LONG CYCLE



Source: J.P. Morgan Asset Management, NCREIF, NAREIT, Standard & Poor's.

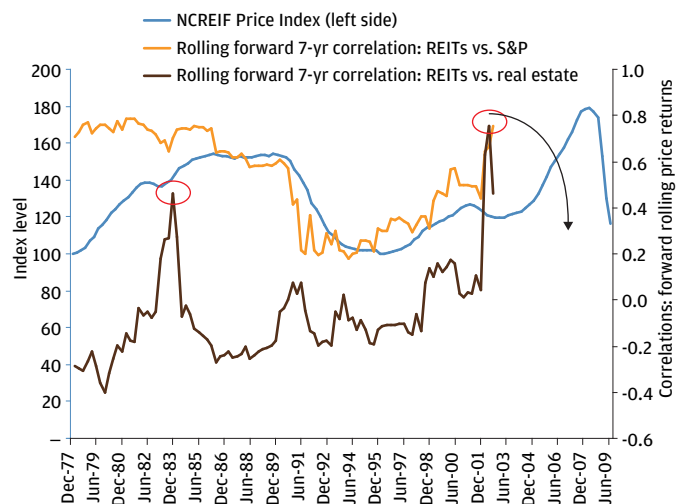
seven-year correlations between REITs and the S&P 500 (noting the fact no REITs were included in the S&P 500 in the 1980s), traded at exceedingly high correlations of about 0.80. Point (1.b) highlights a startling spike in correlations between REITs and direct real estate; This was most likely driven by exceedingly high correlations at the point where real estate values started their decline. What this represents is akin to what the REIT and real estate markets have just experienced over the past year. Note that correlations with equities were also elevated at the same point in both cycles.

Point (2) shows that as real estate values decline from their cyclical peaks, correlations between REITs and real estate also decline dramatically. In our view, this is intuitive given the fact that REITs can hedge against declining real estate values by trading up like equities after major market corrections. The correlations generally remain low over much of the remainder of the long cycle, but point (2.b) indicates a potentially significant spike. This occurs just at the point when real estate values hit bottom and start to recover. Once again, this may be explained by the findings in **Exhibit 5** and **Exhibit 6**, which demonstrate that REITs tend to rally before entering a more sustainable recovery period when real estate values have fully bottomed out.

Points (3) and (4) identify a trend that we interpret as being of potentially critical importance. Soon after the spike between REIT and real estate correlations at the peak of the real estate value cycle (1.b), correlations between REITs and the S&P 500 started to decline, and eventually entered a sustained period (1992–2008) of lower correlations ranging from 0.20 to 0.60. Point (5) identifies what appears to us to be the current stirrings of a recurrence of the two events noted above. The trailing correlations of REITs with real estate spiked at the peak of the most recent real estate cycle, just as they did in the previous cycle. Moreover, correlations with the S&P 500, as in the previous cycle, have reached exceedingly high levels. Our analysis indicates this represents a recurring challenge: during major corrections, the correlations between most asset classes tend to “go to 1.0,” as most markets coalesce in a single swan dive. Fortunately, we believe this to be a rare occurrence that last appeared to take form in the late 1980s and early 1990s.

If this is indeed the case, then strategic, long-term investors in REITs could reasonably expect REIT correlations with equities to enter a long, sustained period of declining and then lower correlations. Our research implies that this is more plausible than expecting correlations to remain at current elevated levels (see **Exhibit 16**, where trailing correlations from **Exhibit 15** are depicted as forward seven-year correlations).

EXHIBIT 16: REIT ROLLING 7-YEAR CORRELATIONS VS. S&P, REAL ESTATE



Source: J.P. Morgan Asset Management, NCREIF, NAREIT, Standard and Poor's.

However, we have identified two caveats to this corollary: (1) a significant number of larger capitalization REITs are now included in the S&P 500 Index, which may act to keep correlations elevated, and (2) the real estate cycle may be accelerating, something that seems evident from the very steep downturn currently underway. Nevertheless, it should be noted that REITs traded at elevated correlations to the S&P 500 in the late 1980s and early 1990s despite the fact that there were no REITs included in the S&P 500 at the time. What's more, while the real estate cycle may accelerate—or shorten in duration—the sharp drop after the peak denominated by point (5) in **Exhibit 15** gives us confidence that the same general cyclical trend lines will hold up over time.

Conclusion

As mentioned in the introduction, after the recent plunge in most asset class values, many strategic investors have begun to take a hard look at the strategic case for and against various assets before deciding to sequence back into riskier investments. Our research—as outlined above—indicates that the strategic case for REITs remains largely intact. Further, we believe there is ample historical precedent to suggest that volatility and correlations—two key areas of concern—will return to levels closer to historical norms. In our appraisal, REITs, over varying time frames, share some of the appealing attributes of other asset classes (such as fixed income, equity and real estate) and also may offer investors a mix of characteristics that provides attractive investment opportunities for strategic allocations in the current environment.



AUTHOR



Michael C. Hudgins

Vice President

Global REITs Strategist

michael.c.hudgins@jpmorgan.com

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The S&P 500 Index is an unmanaged index generally representative of the performance of large companies in the U.S. stock market. The performance of the index does not reflect the deduction of expenses associated with a mutual fund, such as management fees. By contrast, the performance of the Fund reflects the deduction of the mutual fund expenses, including sales charges if applicable. An individual cannot invest directly in an index.

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