Russell Investments

Russell Market Barometer

Your analysis of recent economic events and market movements // July 2008

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Investment Strategist

Market outlook

- **Oil price rises are deflationary, not inflationary. Global stagflation fears are misguided.**
- **Global equity markets offer significant longer-term value.**
- **Local equities to lag global share market returns.**
- **Australian fixed interest fundamentals starting to look attractive.**
- **Australian dollar struggling to reach parity.**

Sub-prime and punishment

It's been a feeling of 'out of the frying pan and into the fire' for investors over the past three months. The collapse of Bear-Stearns in early March marked the bottom of the sub-prime financial crisis and global equity markets staged a 'relief-rally' from mid-March to mid-May. Just as investors were again beginning to feel comfortable, along came the spectre of stagflation triggered by soaring oil prices, rising inflation and renewed US recession fears.

These uncertainties are unlikely to subside anytime soon and markets are likely to remain volatile for several more months. The positive medium term outlook for equity markets is underpinned by low valuations relative to historical benchmarks and the lagged impact of the aggressive monetary easing by the US Federal Reserve. The turning point is likely to come when global investors shift focus from the downside risks to the 2008 outlook to the upside potential to 2009 US economic growth and corporate profits.

Australian shares continue to face more headwinds than their global counterparts. Over the first half of the year, the S&P/ASX 300 has fallen 18% compared to the 13% decline in the S&P 500 and the 12% fall in the MSCI World ex US share price index. Local shares would have fared even worse had it not been for the 10% rise in diversified resources. The danger for local shares is that energy prices retreat from unsustainable levels and commodity prices weaken as global demand slows over the remainder of 2008. The other negatives include a central bank targeting a significant slowdown in domestic demand growth, an exchange rate at 25-year highs and a valuation on price-earnings (PE) ratio terms still high relative to global peers.

Even so, it's difficult to be overly pessimistic about the local equity market. Although valuations may be high relative to other markets, they look attractive in absolute terms. Furthermore, compulsory superannuation contributions are likely to pour up to $30 billion into the equity market this year and the Future Fund is still building up local equity market exposure in its $60 billion plus portfolio. Local equities should move higher by year end but are likely to lag global share-market returns.

"These uncertainties are unlikely to subside anytime soon and markets are likely to remain volatile for several more months."

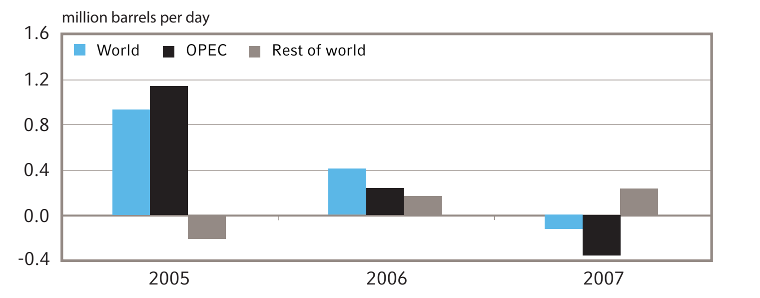
Market outlook (continued)

Oil goes hyperbolic

Oil prices have doubled over the past 12 months, rising to a peak of US$145 per barrel in early-July. Escalating energy costs have replaced sub-prime as the number one worry for stressed investors. As is always the case when a market goes into hyper-drive, there are some fundamentals that justify higher prices. Oil supply has been falling as a result of OPEC cutbacks and problems with non-OPEC suppliers while demand from China and other developing economies has accelerated.

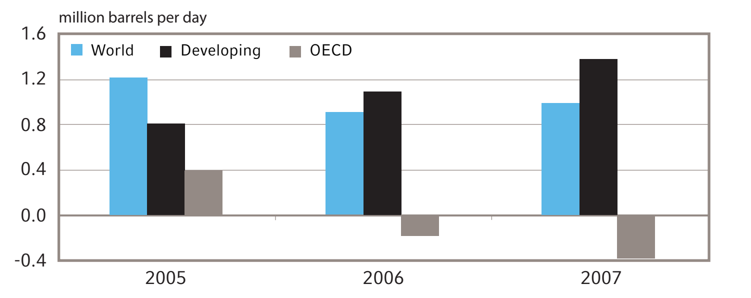
There is an intense debate as to how much of the price increase is justified by fundamentals and how much reflects the huge growth in commodity investment funds (which since 2003 have grown from US$13 billion to US$260 billion). There is also a suspicion that demand has been boosted recently by a build-up in China's oil reserves ahead of the Olympics. The truth probably lies somewhere in the middle and it would not surprise to see oil head back towards US$100 over the next few months as some of the speculative fizz comes out of the market. Oil consumption in the developed countries has been falling for the last year and this trend should continue. It's also likely that demand growth will soon start to cool in the developing economies as countries like China slow their economies in response to inflation pressures, and as consumers across Asia and the Middle East cut back on demand in response to higher prices from reductions in oil price subsidies.

EXHIBIT A Annual oil production change



Source: BP Statistical Review of World Energy

EXHIBIT 2A Annual oil consumption change



Source: BP Statistical Review of World Energy

Market outlook
(continued)

Living in the 70s?

The most pessimistic scenarios feature one word – stagflation – the fear of a return to the 1970s world of rising inflation and unemployment as soaring energy costs entrench high prices and slow economic growth. Headline inflation rates have risen around the globe, reaching 4.1% in the United States, 3.3% in Europe, 3.0% in the United Kingdom and 4.2% in Australia at the same time that economic growth has been well below trend (apart from Australia where economic growth has been strong until recently).

There is one important difference between the now and the 1970s – wages are not surging in response to the higher cost of living. During the oil shocks of the 1970s, unions in most developed economies secured wage gains to compensate for the increased cost of living. The result was an escalating wage-price spiral that established high inflation as a fact of life.

This time, there is no evidence of a wages push across the G-7 economies. In the United States, labour costs are moderating thanks to rising unemployment and sustained productivity growth. Unions have less power and central banks have much more credibility as long-term inflation fighters. Exhibit B shows the wide gap between headline and core inflation across the US, Europe and the UK. So far, high headline inflation rates have yet to flow through to core measures that exclude food and energy costs.

A point worth noting is that energy and commodity prices add to inflation only while they are rising. A one off adjustment in energy prices (as seems likely right now) causes a lift in the price level. This results in higher inflation as it is happening but the impact drops out after energy prices have stabilised at the new, higher level. This, of course, causes a painful one-off reduction in community purchasing power, but does not cause a permanent increase in the rate of inflation , unless it feeds into wages growth and inflation expectations.

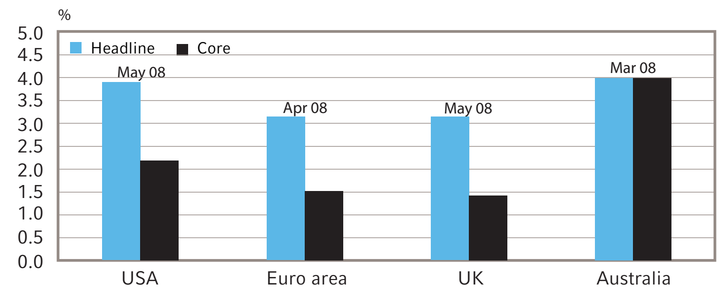
Exhibit B also provides insights into how the different central banks are handling the inflation threat. The US Federal Reserve (Fed) is mostly focused on core inflation, hence the Fed funds rate at just 2%. It's possible that the Fed will lift interest rates once or twice before the end of the year to remove some of the monetary policy 'insurance' put in place at the depths of the financial crisis, now that the risk of systemic financial collapse seems minimal. Even so, the Fed is likely to persist with an accommodative monetary stance for some time yet, given the threats to economic growth from mortgage foreclosures, slowing consumer spending and rising energy costs. It will, however, talk aggressively about inflation risks to keep inflation expectations well anchored.

The Bank of England also pays more attention to core rather than headline inflation and has lowered interest rates three times since last November. The European Central Bank, however, has a much stricter inflation target that requires it to keep headline inflation below 2%. Despite a sluggish economy, the ECB lifted its official rate by a quarter-point to 4.25% in early July.

The chart also shows why the Reserve Bank of Australia (RBA) is taking a more aggressive position. In the rest of the world, inflation is rising mainly because of energy costs. Take out energy costs and inflation is still low. In Australia, by contrast, core inflation is rising at the same rate as headline inflation. Australia's inflation problems are more widespread. Unlike the rest of the world, Australia's economy has hit capacity limits producing 'demand-pull' in addition to 'cost-push' inflation pressures.

The RBA faces a difficult balancing act over the remainder of 2008. On the one hand, there is ample evidence that the monetary tightening so far

EXHIBIT B **Headline and core inflation**



Source: Datastream

Market outlook
(continued)

is causing plenty of pain in the housing market and for consumers and businesses. On the other, the economy is about to be hit by an enormous increase in the terms of trade thanks to a tripling in the contract prices for coking coal and a near doubling in iron ore prices. Some estimates suggest this will deliver a 4% boost to national income over the next few months as the higher prices flow from the mining sector and into the broader economy.

The tone of recent RBA commentary suggests it feels monetary policy is tight enough to slow domestic demand sufficiently to return core inflation below 3%. Meanwhile it will be watching carefully the impact of the commodity income surge over the second half of the year.

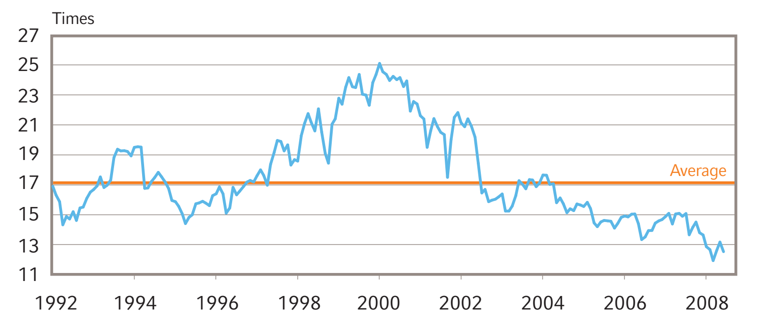
Long-term value in global developed world equities

Global developed equity markets continue to show exceptional value with the forward price to earnings (P/E) ratio hovering near 18-year lows at 12.5 times.

The bottom up consensus forecast from stockbroking analysts is that earnings-per-share (EPS) will grow by 12% over the next twelve months. Consensus analyst expectations are renowned for being overoptimistic. As Exhibit D shows, the consensus failed to predict the 28% decline in EPS during the 2001 global recession. The consensus did, however, scale back earnings forecasts from over 20% to under 10% in the 12 months leading into the earnings collapse. This time, the consensus has slightly *upgraded* earnings forecasts over the past twelve months despite the credit crunch, soaring energy costs and stagflation fears. Analysts have been warned for months about the dire economic outlook, but have steadfastly continued to predict double-digit profits growth. Clearly, there is a risk of earnings downgrades in coming months, but so far, corporate earnings are showing remarkable resilience around the world.

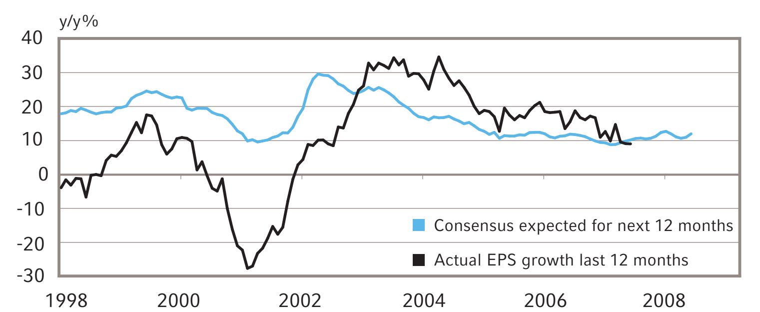
Valuation is, of course, a poor timing tool and we should remember Keynes' famous dictum that "the market can stay irrational for longer than you can solvent". However, investors with a time horizon beyond the next six months should take note of the low PE ratios on offer combined with resilient profit expectations.

EXHIBIT C **1-year forward PE ratio: MSCI world**



Source: Source: I/B/E/S

EXHIBIT D **MSCI developed world: Forward & trailing EPS growth**



Source: I/B/E/S

Market outlook
(continued)

It's all relative

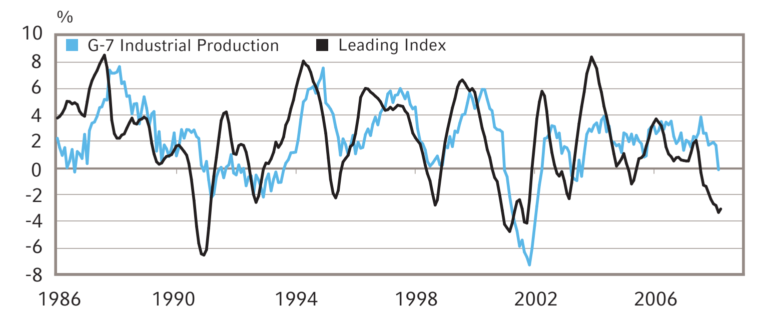
Australian investors can be forgiven for feeling a little shell-shocked when surveying the local market carnage. The S&P/ASX 300 fell 18% over the first half of 2008, compared with a 13% decline in the S&P500 and a 12 fall in the MSCI World ex US share index. Diversified resources have been the one bright light, rising 10%. Excluding resources, the rest of the market fell 28% over the first half of 2008.

Australian bank shares fell 29% over the first half of 2008, compared to the 38% decline in US bank shares. There are legitimate concerns about the outlook for local bank earnings given the RBA's determination to slow credit growth. However, Australian banks have very little direct sub-prime exposure, making it hard to justify the similar price performance to sub-prime ravaged US banks.

The negatives for the Australian share market continue to be a valuation on PE ratio terms that is still high relative to global developed markets, a central bank targeting a significant slowdown in domestic demand growth and an exchange rate at 25-year highs. Add to this the risk of a pull-back in commodity prices as industrial production across the G-7 economies begins to contract.

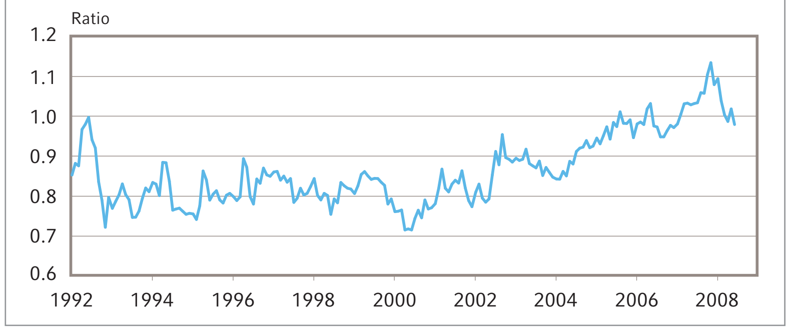
However, the one-year forward PE ratio, at 12 times, is lower than when the bull-market kicked off at the end of 2002 and the dividend yield is above 4% – traditionally a strong value indicator. The local market faces some tough headwinds (and the risk of a commodity reversal), but the long-term valuation characteristics are sound. It does, however, seem set for a period of underperformance relative to other global developed markets.

EXHIBIT E G-7 Industrial Production and Leading Index



Source: OECD

EXHIBIT F Australian forward PE ratio relative to the world



Source: I/B/E/S

Market outlook (continued)

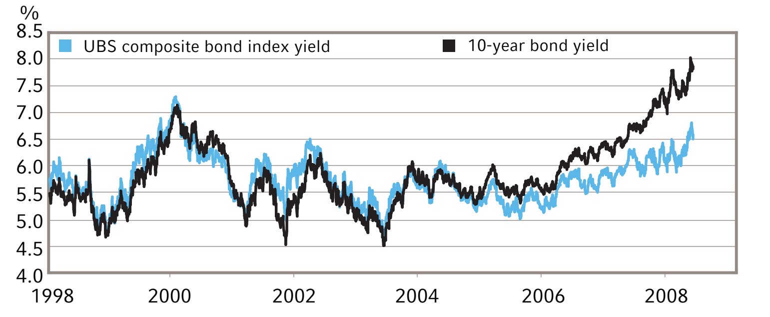
Time to look at fixed interest?

Australian fixed interest has been an unloved asset class over the past few years. From 2002 to 2007 when Australian shares were returning 21% per annum, the UBS Composite Bond Index delivered just 4.5% per annum. Bonds have provided only partial relief from the credit crunch over the past year, returning 4.0% in the year to June. Most bond funds have been overweight credit based securities with the result that the median bond fund has generated returns around 100 basis points below the benchmark.

Australian fixed interest is beginning to show signs of good value. The 10-year government bond yield at 6.5% looks more attractive than for several years. Non-government securities make up close to half of the UBS Composite Bond Index and the overall yield on the index is close to 8%, reflecting the blow-out in credit spreads.

The average duration of the bond index is just over three years, meaning a 100 basis point yield decline will deliver around 300 basis points in capital gain. An Australian economic slowdown should deliver lower government bond yields, and credit spreads look to have peaked. Australian bonds are starting to look interesting.

EXHIBIT G Australian fixed interest yields



Source: Datastream

Market outlook
(continued)

Australian dollar – parity just out of reach

The Australian dollar has been stuck in a 94-97 cent range for the past couple of months, threatening on a couple of occasions to push through to parity. It is hard to imagine a more bullish environment for the A$ – short-term interest rate differentials are the widest since 1991, pessimism on the US economy is deeply entrenched and prices for Australia's main commodity exports, such as coal, iron ore and wheat have gone through the roof.

The main factor behind the A$ strength over the past five years has been US$ weakness rather than commodity prices or interest rate differentials. Europe doesn't export a lot of commodities, yet the euro has experienced an almost identical appreciation against the US$ since 2002.

Given that the A$ is only a few cents away, it would be foolish to suggest that it won't achieve parity. But the fact that the A$ seems to have stalled amid such a bullish environment hints that the upswing may be running out of steam. On our estimates, the A$ is close to three standard deviations from its purchasing power parity value of 70¢. We may be close to the peak in the currency cycle.

Conclusion: Pessimism fully discounted

The current investment backdrop is as challenging as any faced in the past 25 years. Amid the market chaos, however, investors should step back and ask the two fundamental questions: "what is the long-term outlook for profits?", and "what price am I paying for these profits?". Markets face plenty of headwinds in the near term and more volatility seems likely, but right now, investors are being offered the opportunity to buy future growth and profits at significantly discounted prices.

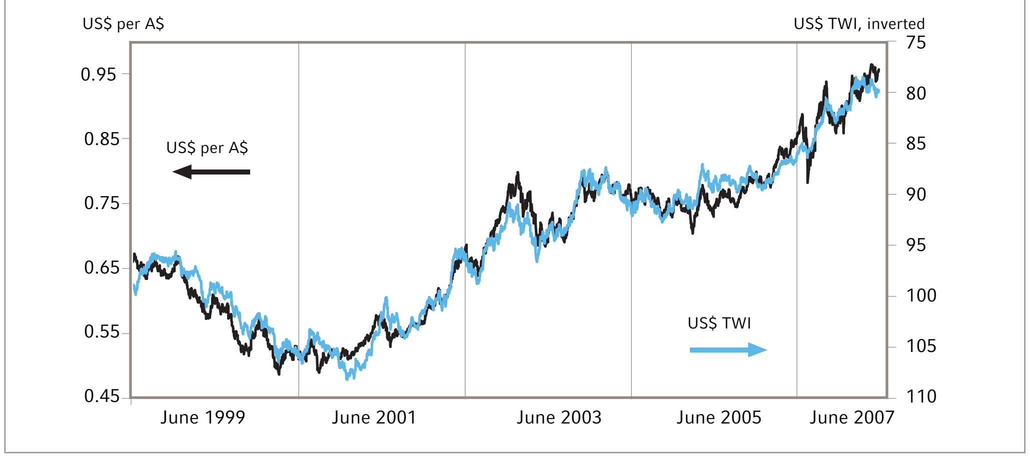
"The fact that the A$ seems to have stalled amid such a bullish environment hints that the upswing may be running out of steam"

Australian dollar

- **US$ weakness still main factor behind A$ strength.**
- **Surging commodity prices present risk of further A$ gains.**
- **A$ now near three standard deviations above purchasing power parity value.**

The biggest factor behind the rising A$ in recent years has been the decline in the US$. Broadly, every 1% decline in the trade-weighted US$ has equated to a 2.5% increase in the A$ versus the US. This relationship has continued to hold during 2008. In the first six months of 2008, the A$ rose 9.2% against the US$ and the trade-weighted US$ fell 3.5%.

EXHIBIT 1A **US$ per A$ versus inverted US$ TWI**

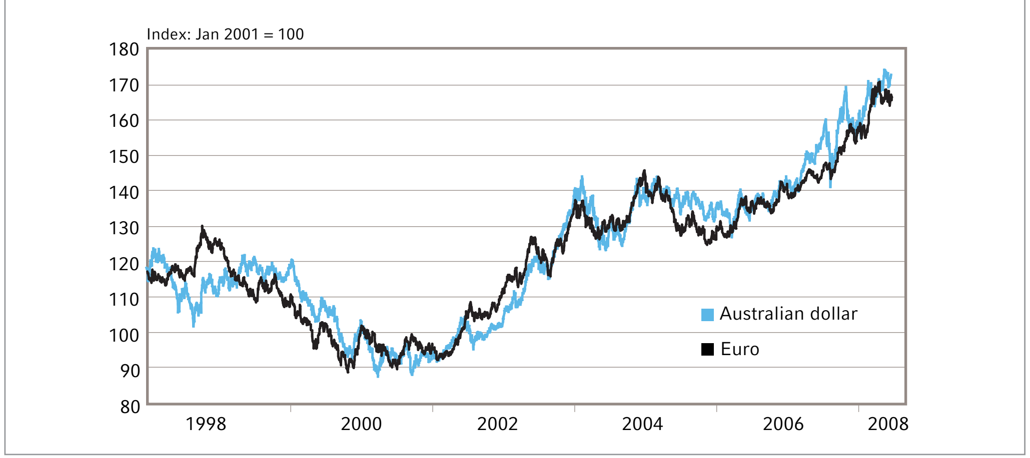


Source: Datastream

Another way of making the same point is to compare the movements in the A$ and euro against the US$ over the past few years.

The chart shows the A$/US$ and the euro/US$ indexed to January 2001. It shows that the A$ and euro have moved almost identically against the US$ in recent years. The main reason for the A$ being above 90¢ is US$ weakness.

EXHIBIT 1B **A$ & euro vs US$**



Source: Datastream

Australian dollar

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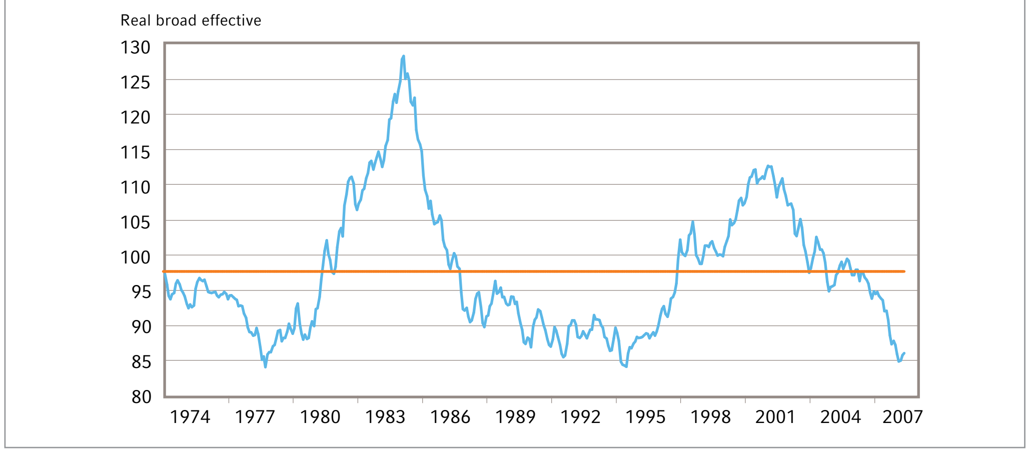
The US$ stabilised in real trade-weighted terms over the June quarter, however it is 8% lower than a year ago and has fallen 24% from the early 2002 peak. The negatives for the US$ remain the current account deficit at 5% of GDP and low US interest rates. On the positive side, the Fed is making threatening noise about 'normalising' US interest rates and there is clear evidence of an export upswing.

EXHIBIT 1C **United States: Real trade weighted dollar**

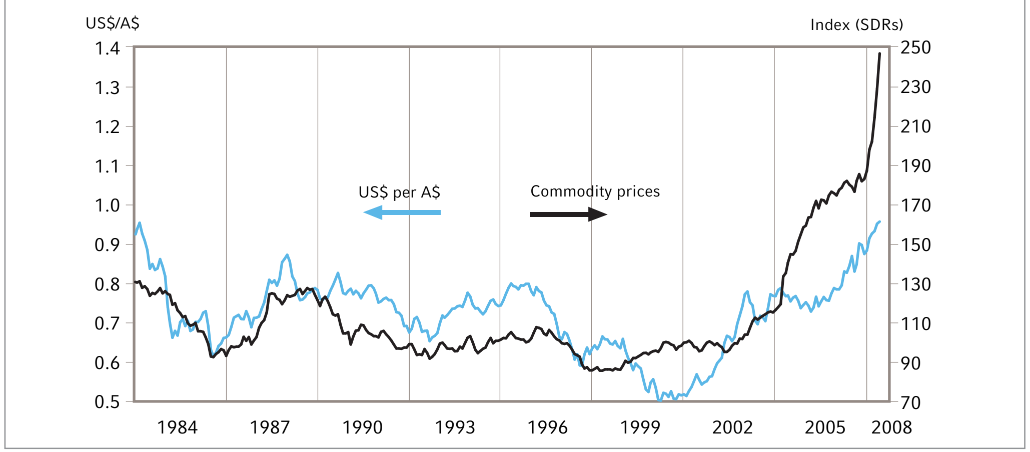


Source: US Federal Reserve

Commodity prices have gone vertical over the past couple of months. The RBA's index of export weighted commodity prices rose 36% over the first six months of the year. This index will post more spectacular gains over the next few months as the tripling in coal prices and 95% increase in iron prices are incorporated into the index.

The A$ has traditionally been correlated with commodity prices. As the previous chart shows, the A$ rises so far have little to do with commodity prices – it's been a weak US$ story. However, the magnitude of commodity price gains could see the A$ stay stronger for longer and challenge our view that the A$ is near a peak.

EXHIBIT 1D **RBA commodity prices & the AUD**



Source: RBA

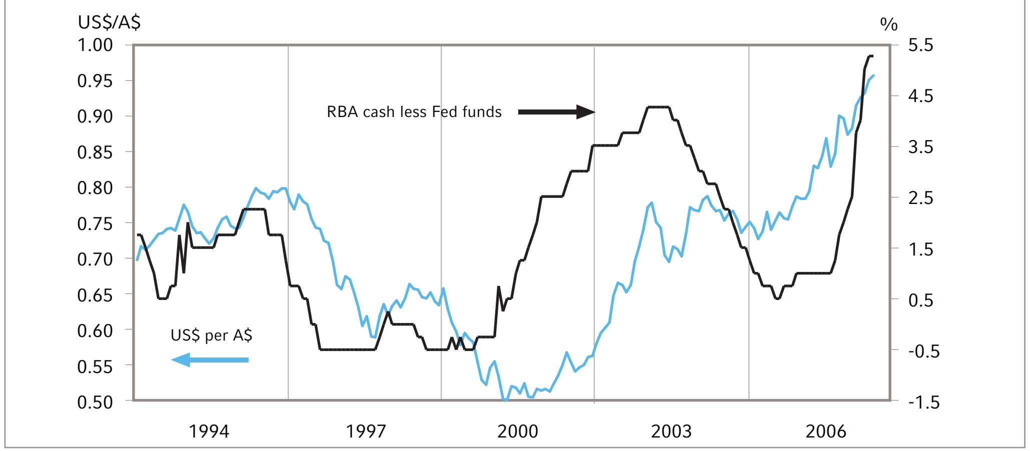
Australian dollar

(continued)

Interest rate differentials moved further in favour of the A$ during the June quarter after the Fed eased by 25bp in April, taking the funds rate to 2.0%. Interest rate changes matter move than interest rate levels for currencies.

Market expectations are shifting towards a Fed tightening late in 2008 and away from further RBA tightening. This suggests that interest rate differentials may not place much more upward pressure on the A$ and may soon be a factor that favours US$ strength and A$ weakness.

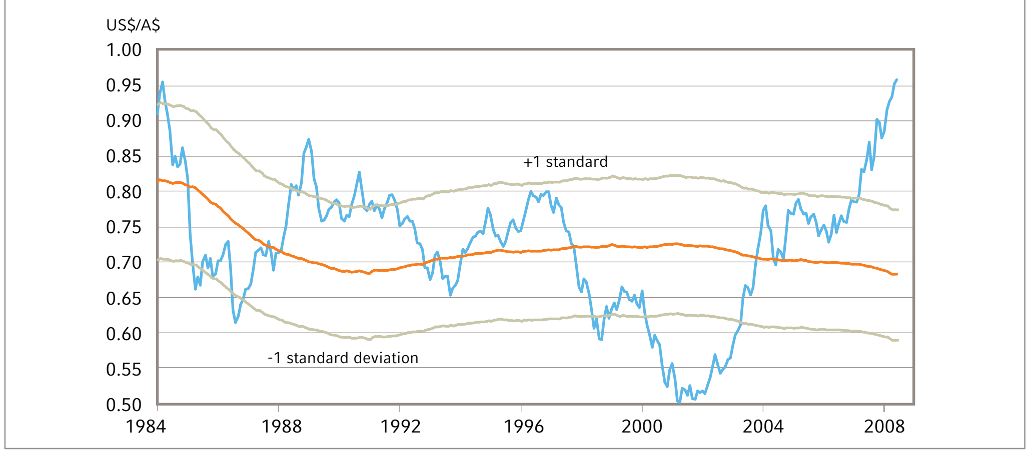
EXHIBIT 1E A$ and interest rate differentials



Source: RBA

We calculate the purchasing power parity value for the A$ at 69¢. At 95¢, the A$ is nearly three standard deviation above its PPP value. On this basis, the A$ is more over-valued now than it was undervalued in 2001 when it fell to 48¢.

EXHIBIT 1F US$ per A$ & PPP value



Source: Russell Investments

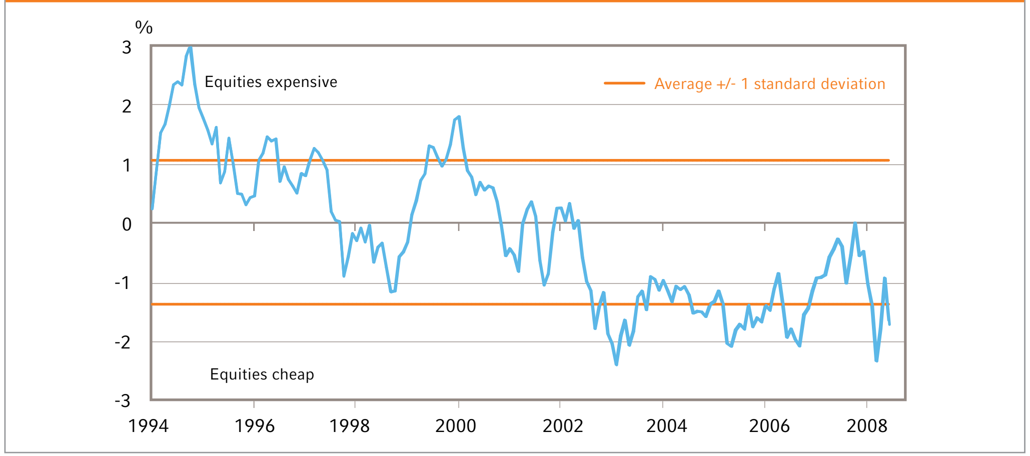
Equity market valuation

- **Australian equities still cheap relative to bonds.**
- **Our equities model, which provided a 20% overvaluation signal in October, now says the market is 8% undervalued.**
- **Earnings growth still supportive. In particular, resource sector earnings expectations trending higher.**
- **Strong US equity market valuation signal.**

The 'Fed model' compares the forward earnings yield on equities (the inverse of the PE ratio) with the yield on 10-year government bonds. Equities are expensive (or bonds are cheap) when the bond yield is above the equities yield. Equities are cheap (bonds expensive) when equities yield more than bonds.

The yield gap suggests the local market has returned to the valuation levels that prevailed in early 2003 when it embarked on a five-year bull market upswing.

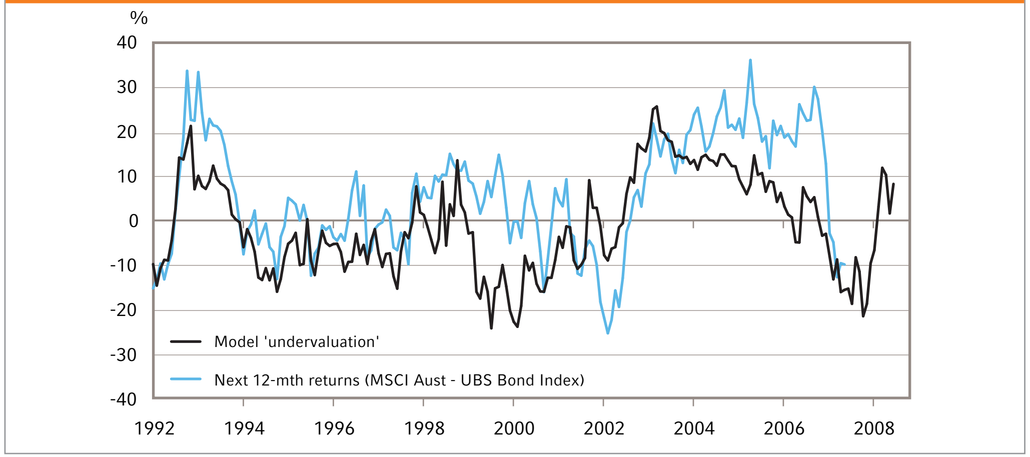
EXHIBIT 2A **Australia: Bond yield less earnings yield**



Source: I/B/E/S, Datastream

Our Australian equities model signalled that the market was 20% overvalued last October. With the market correction, the model now suggests the market is 8% undervalued. The model uses 12-month forward earnings, 10-year government bond yields and the deviation of current earnings growth from long-term trend.

EXHIBIT 2B **Australia: Equities vs bonds model – MSCI Australia verus 10-year bond**

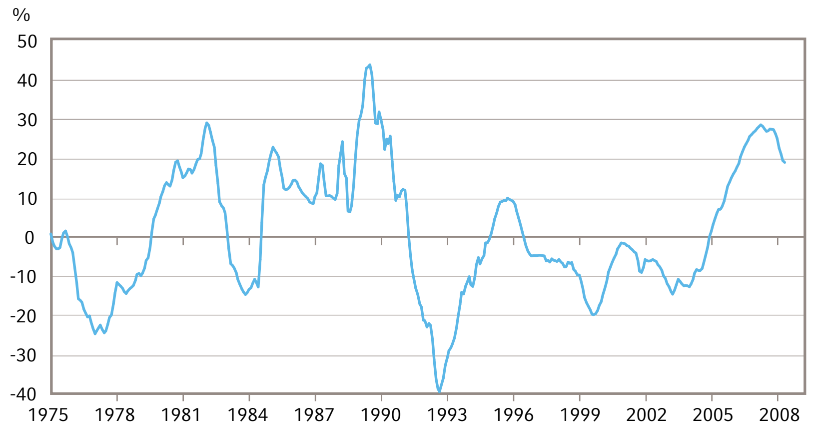


Source: Russell Investments

Equity market valuation
(continued)

The key difference between the model and the simple 'Fed model' is the use of earnings relative to trend. A forward PE ratio will look misleadingly low if earnings are unsustainably above trend. The PE will be misleadingly high if earnings are well below trend levels. The accuracy of the model's predictions largely depends on how trend earnings are calculated. We use a smoothing technique (a Hodrick-Prescott filter) to calculate a measure of trend earnings that adjusts over time. Earnings are currently around 20% above long-term trend levels.

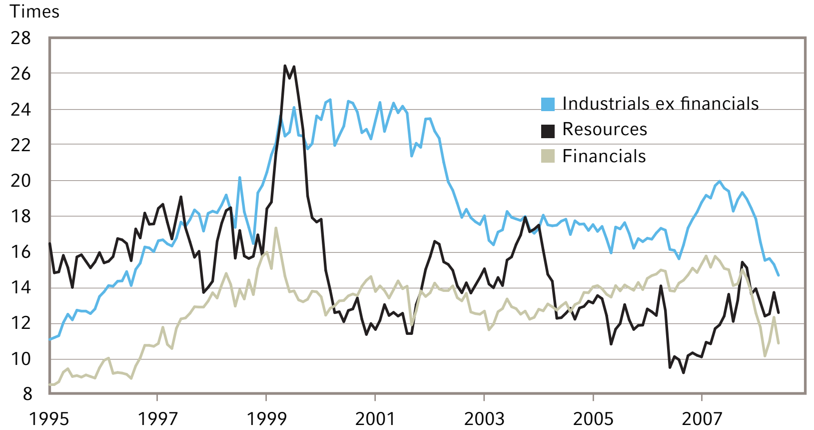
EXHIBIT 2C Australia: One year trailing EPS relative to long-run trend



Source: Russell Investments, Datastream

Financials have been at the centre of the sub-prime storm losing 30% over the first half of the year. The forward PE ratio has fallen from 15.0X in mid-2007 to 10.8X in June. The forward PE ratio for diversified resources has fallen from 15.0X last November to 12.5X, but is still above the 9.0X the sector traded on in late 2006. Industrials ex financials at 14.6X still carry the valuation overhang from the 2006 M&A boom.

EXHIBIT 2D Forward PE ratios by sector



Source: I/B/E/S

Equity market valuation
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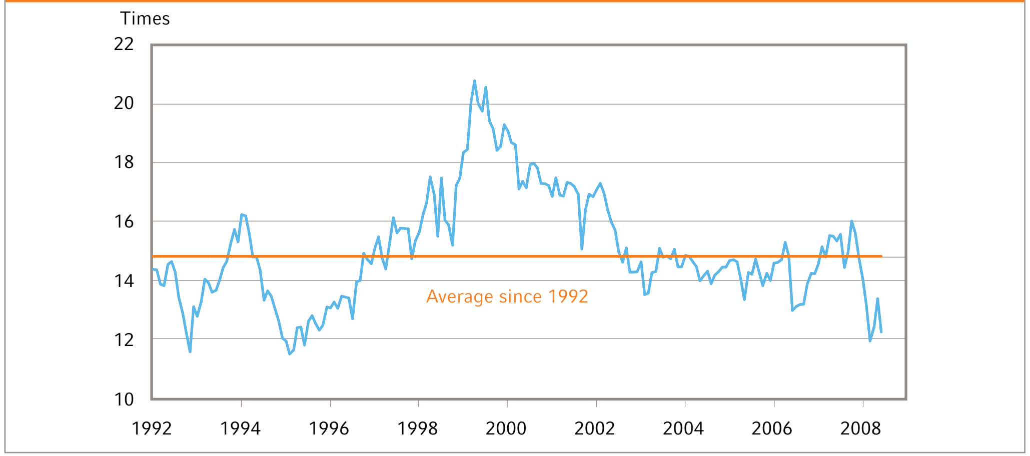
The PE ratio based on one-year ahead consensus expected earnings stood at 12.2X in June, well below the peak of around 16X in early October.

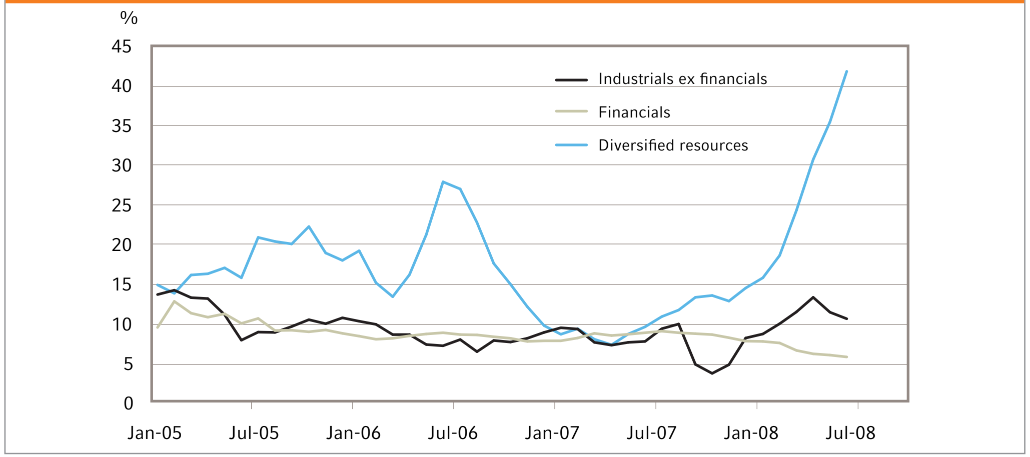
EXHIBIT 2E 1-Year Forward PE ratio: MSCI Australia



Source: I/B/E/S

Earnings growth continues to be supportive for the local market. The I/B/E/S survey figures for June show sell-side analysts forecasting 17% earnings growth over the next 12 months. Earnings growth expectations have gone through the roof for resources, where the consensus now expects 40% earnings growth over the next 12 months.

EXHIBIT 2F Australia: 1-year ahead EPS growth

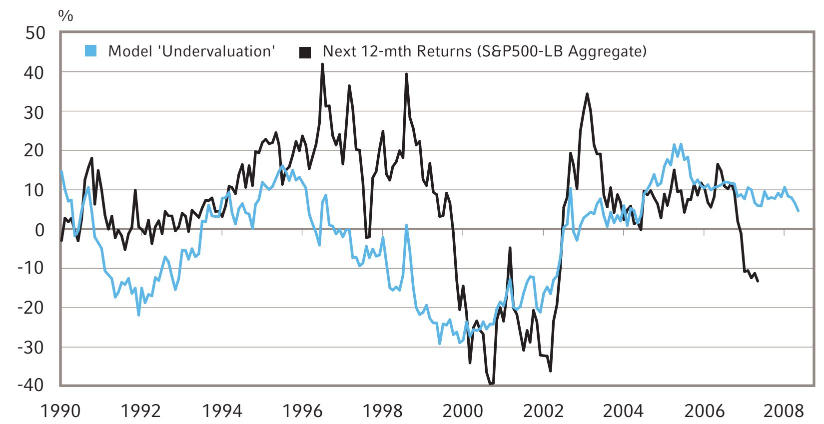


Source: I/B/E/S, Russell calculations

Equity market valuation
(continued)

Our US team model S&P500 valuation using 12-month forward earnings, "A" rated corporate bond yields, an earnings growth proxy based on consumer confidence, and a relative return momentum indicator. The signal provided by this model about the 12 month outlook for equity market returns has deteriorated due to slowing momentum and the large fall in consumer confidence.

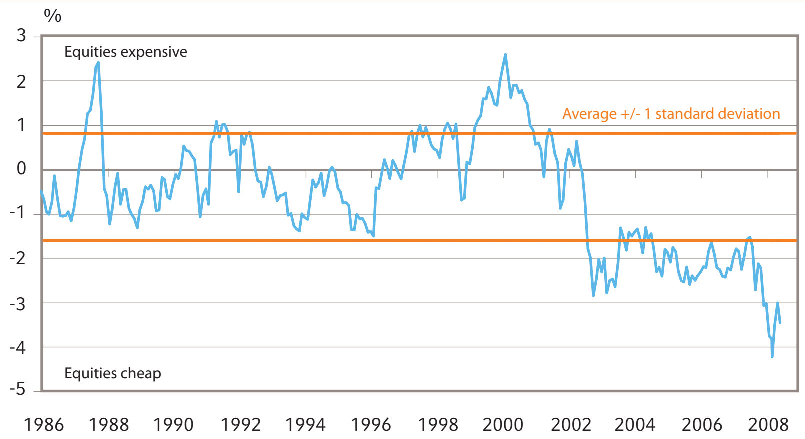
EXHIBIT 2G **United States: Equities vs bonds model S&P500 versus Moody's A Debt**



Source: Russell Investments

The most compelling signal in favour of US equities comes from a 'Fed-model' that compares the forward earnings yield on the S&P500 with the 10-year US Treasury yield. This provides the strongest signal in favour of equities since at least 1986. This signal might be exaggerated by the low level of bond yields or by the fact that consensus earnings estimates still seem too high and in danger of downgrade. Nevertheless, it would require a significant and sustained decline in earnings to negate the longer-term positive signal provided by this valuation measure.

EXHIBIT 2H **US: Bond yield less earnings yield**

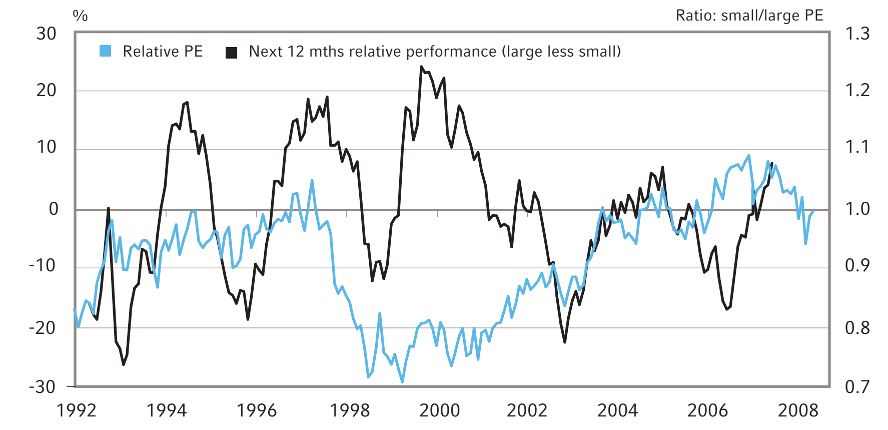


Source: I/B/E/S, Datastream

Equity market valuation
(continued)

Small-caps have underperformed large caps by 8% points over the past year. Small-caps are trading at a PE ratio discount to large caps for the first time since late 2005. The forward PE ratio for the Small Ords is now close to the PE ratio for the ASX100, providing no strong signal about relative performance prospects.

EXHIBIT 21 Small caps/large caps forward PE versus next 12 months relative performance



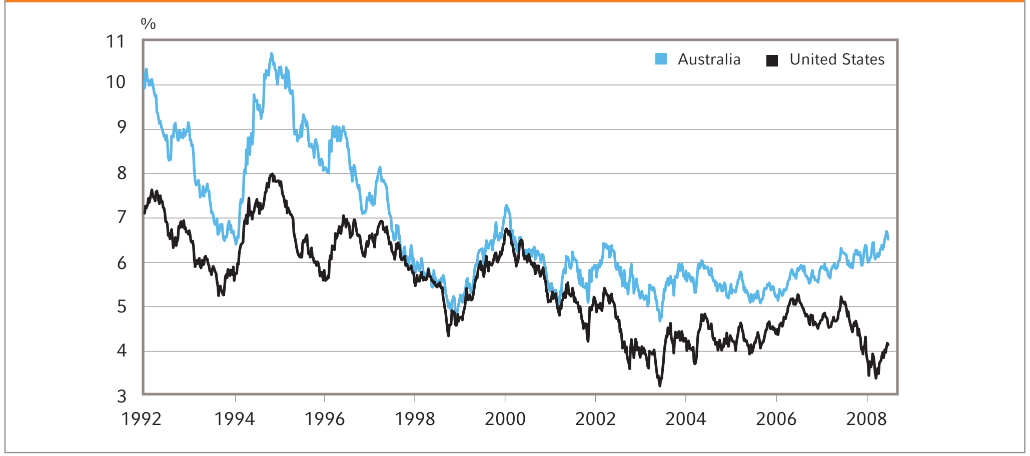
Source: UBS, Datastream, I/B/E/S

Fixed interest markets

- **Bond markets sell-off over June quarter.**
- **US treasuries remain expensive with nominal yields around 4.0% and real yields at 1.5%. Australian bonds, by contrast, while not cheap, look reasonable value with a yield around 6.5%.**
- **Credit spreads show signs of peaking and credit based investments now starting to show good value.**

Australian 10-year bond yields rose 41bp during the June quarter to 6.45 %, and US Treasury yields rose 55bp to 3.98%.

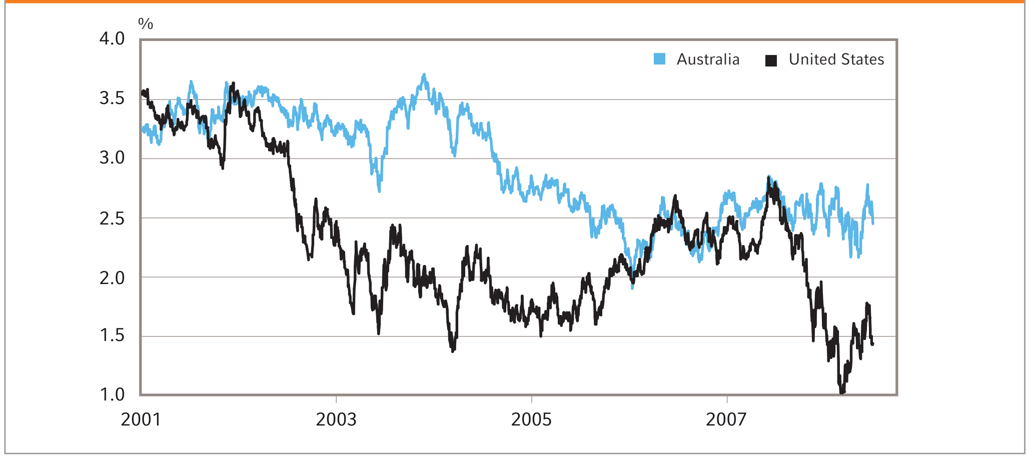
EXHIBIT 3A 10-Year government bond yields



Source: Datastream

Inflation protected bond yields (TIPS in the US and inflation-linked bonds in Australia) provide a good measure of the real risk-free interest rate. Theoretically, real interest rates should, over time, equal the potential real growth rate of an economy. Most estimates place potential GDP growth at around 3.0% for the US and 3.25-3.5% for Australia. Inflation linked yields rose 37bp to 1.48% in the US since over the June quarter. Inflation linked yields rose 7bp to 2.52% in Australia. This makes Australian yields look moderately expensive, but much better value than in the US.

EXHIBIT 3B Inflation protected bond yields

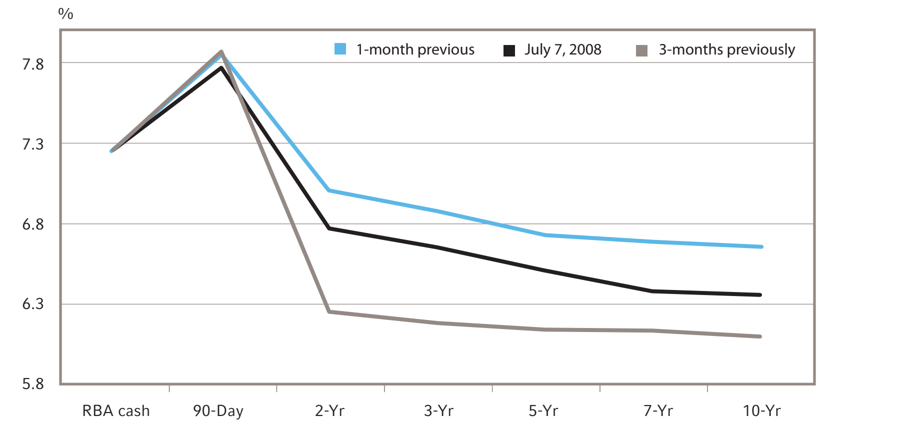


Source: Datastream

Fixed interest markets (continued)

The Australian yield curve remains inverted. Ninety-day bank bill yields are still well above cash rates, but this seems more to do with sub-prime related risk premiums than with market expectations for further monetary tightening. Futures markets are currently pricing that the RBA's cash rate will remain unchanged at 7.25% over the next 12 months.

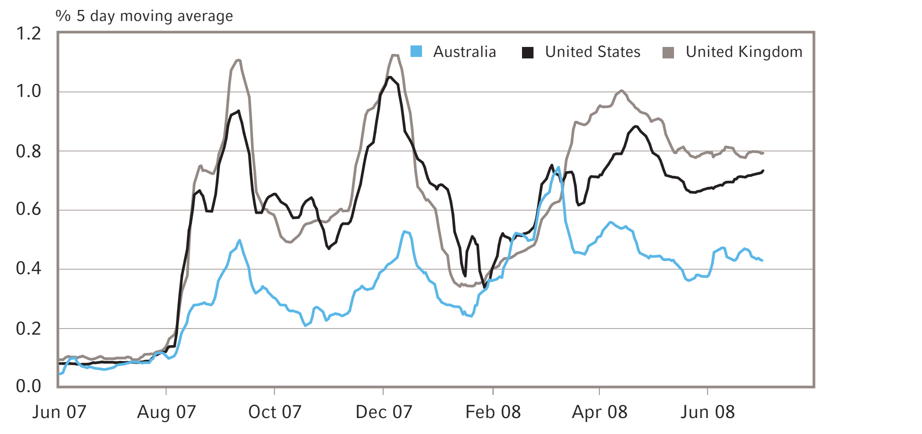
EXHIBIT 3C **Australian yield curve**



Source: Datastream

The full force of the sub-prime crisis is apparent in the spread between the overnight indexed swap (OIS) rate and the 3-month interbank rate. Since August, this spread has at times blown out to over 100bp in the UK and US as banks have become wary of each other's creditworthiness. It shows how sub-prime fears subsided mid-way through the June quarter, but have since began to trend higher as concerns about bank credit-worthiness continue.

EXHIBIT 3D **3-month interbank spread to overnight indexed swap**



Source: Datastream

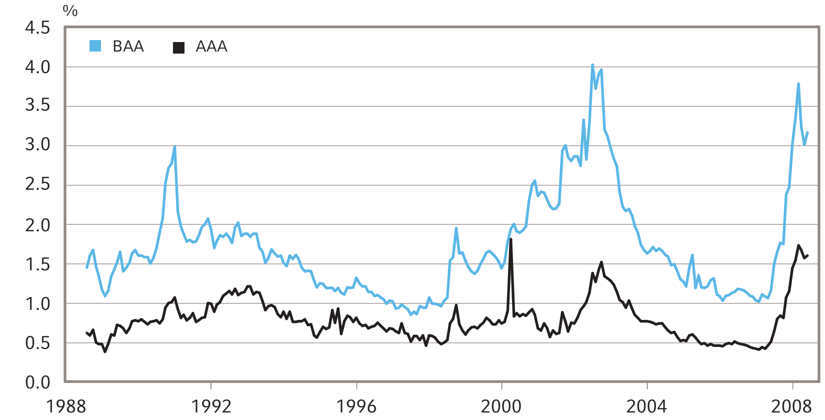
Fixed interest markets
(continued)

Corporate bond spreads have shown signs of peaking over the June quarter. The spread between AAA rated debt and government bonds eased slightly from a peak of 172bp at the end of March to 166bp at the end of June. The BAA spread has fallen from 377bp to 324bp.

High yield borrowers now pay 736bp above government bonds, down from 810bp in March.

Value is starting to return to credit markets. There may be another leg down if defaults move significantly beyond sub-prime mortgages, but similar to equities, credit is now offering value to investors with a medium term focus.

EXHIBIT 3E US investment grade credit spreads



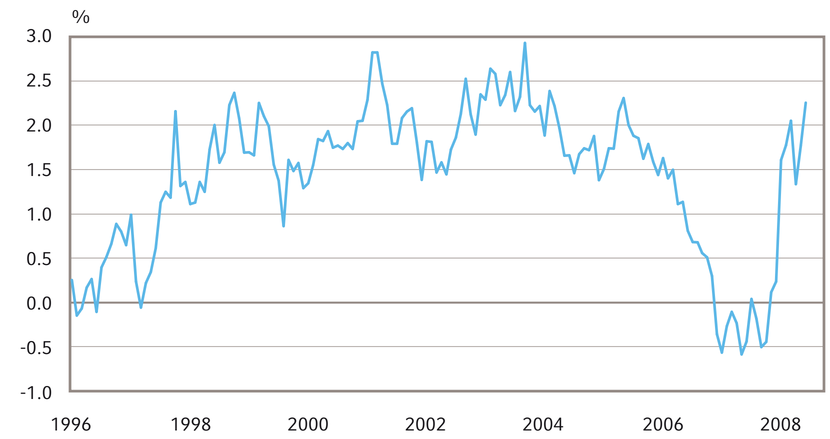
Source: Lehman Brothers

Property

- **LPT index down over 45% since February 2007 peak.**
- **Value is starting to emerge, but sector's problems not over yet with asset sales and earnings downgrades still to come.**
- **Listed property overvaluation was a global story. Value also returning to US REITs.**

Listed property trusts continued to collapse over the June quarter, losing another 20% to take the total fall since the February 2007 peak to -46%. One sign that valuation pressures are easing is that the distribution yield is now 230bp above the 10-year bond yield.

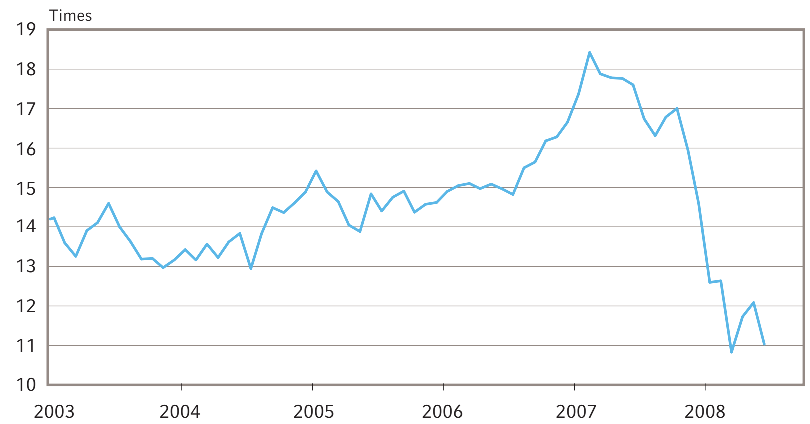
EXHIBIT 4A **LPT yield premium to 10-year bond yield**



Source: UBS

The LPT sector is now on a forward PE ratio of 11 times. This compares with the PE ratio for the overall equity market of just over 12 times. The sector has moved from being dangerously overvalued at the beginning of 2007 to more reasonable valuation levels.

EXHIBIT 4B **Forward PE ratio: S&P/ASX 300 Property Index**



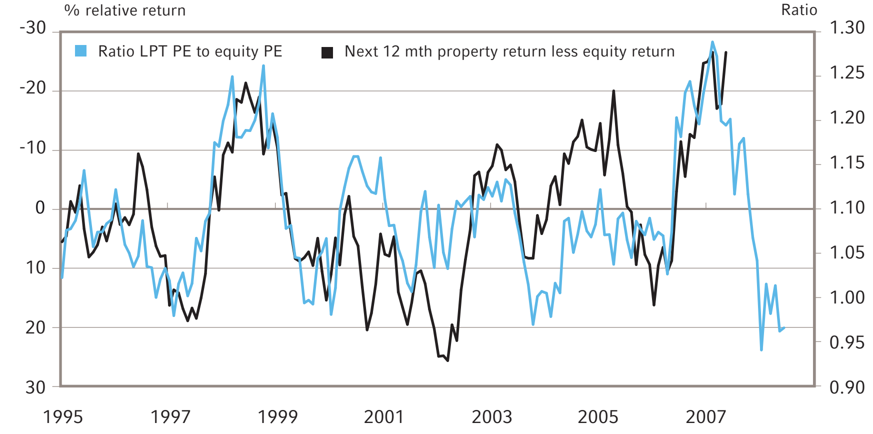
Source: I/B/E/S

Property

(continued)

One measure that suggests the worst might be over for the sector is the ratio of the LPT forward PE ratio to the broader equity market. The chart compares the relative PE ratio to the performance of the LPT index to the broader equity market over the next 12 months. LPTs typically outperform equities in the 12 months after the PE ratio declines relative to the broader market. The chart suggests that LPTs might outperform equities over the next 12 months.

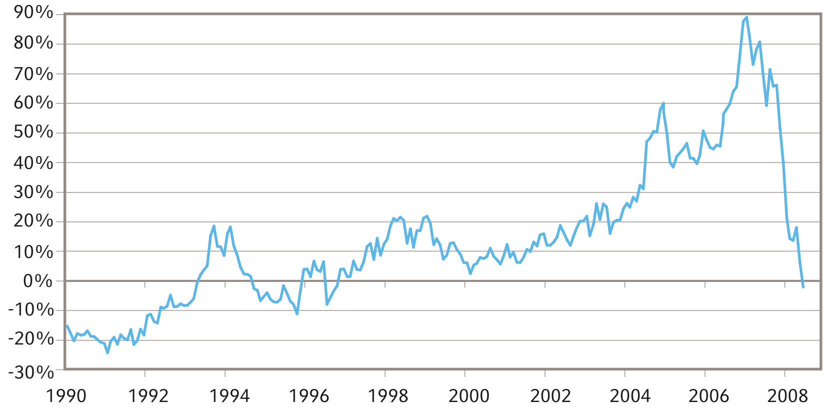
EXHIBIT 4C LPT PE relative to market PE & next 12 mth relative performance



Source: I/B/E/S

The price to net tangible assets (NTA) ratio continued to plunge over the June quarter. The sector is trading at a 2.5% discount to NTA compared to the 89% premium to NTA in January 2007. The sector last traded at discount to NTA in 1996. One factor that boosted the value of the sector relative to NTA was the advent of 'stapling'. This involved the merger of the property development and funds management companies with the traditional listed property trusts. Around three-quarters of of trusts are now stapled securities. According to UBS, the stapled trusts have a 7% premium to NTA and the non-stapled trusts are trading at a 24% discount to NTA.

EXHIBIT 4D LPT price to net tangible assets



Source: UBS

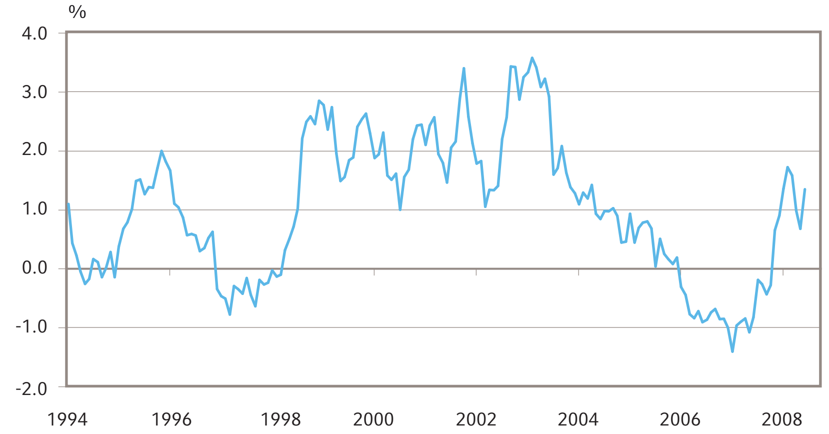
Property

(continued)

The NARIET index of US listed property securities fell 6.0% over the June quarter taking the loss over the past year to 18%. The REIT index has fallen 30% from the January 2007 peak.

The REIT dividend yield is 130bp above the 10-year treasury yield. However the low level of treasury yields means this spread gives a misleading impression of value. The sector's yield of just over 5% is still low by historic standards.

EXHIBIT 4E US REIT yield versus 10-year treasury



Source: NAREIT, Datastream

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