Written on Monday, 16 September 2024

Should you sell REITs now and buy back later? How long can REITs keep going up?

I recently received this great question from a reader:

"Hi FH, Can you give me your opinion?

While expecting some interest rates cut, the likelihood of US slipping into recession has become bigger.

I have some REITs counters like CICT, Keppel DC Reits and MIT which are making profit of about 20% and CDL losing about 15%.

I understand interest rate cuts will benefit the REIT but at the same time, I am worried about the recession.

Do you think it is good idea to sell the REITs now and buy back later?

I intend to hold on to CDL and to buy more if it drops further."

My response?

For the record, this was my answer:

"If you don't mind I may write further on this to expand on the answer.

But the short answer is that it depends on how much of your portfolio is invested, and the counter in question.

If you have a lot of your portfolio invested, and if the charts for the counter looks like its topping out, then it may make sense to take profit on a certain percentage of the REITs (eg. 1/3, or possibly more).

For me at least, REITs are about 30% of my portfolio. But charts wise the REITs look bullish so I am continuing to let them run for now.

But this question needs to be answered unique to each investor. If you have very heavy REIT exposure, and a big drawdown from here would make you uncomfortable - doesn't hurt to lock in the profits for a certain % of your REITs."

But as you can imagine, the answer to this question is a nuanced one, and the more I thought about it, the more I thought my answer didn't really do justice to the question.

Like many of you, I have decent exposure to REITs (30% of my portfolio), so this question is pretty closer to my heart, and I wanted to spend some time properly discussing this.

Why does this question matter? Some background

Here's the Nikko AM REIT ETF.

Since the lows in early July, the index has rallied almost 15%, and that's before including dividends.

The last time the index was this high was in Jan 2024, and over the next 6 months the index gave back most of its gains.

The question of course is whether that is going to repeat, or if REITs are going even higher.

Investors today have a decision to make:

1. Lock in the profits

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2. Keep holding on in the hopes that REIT prices go even higher

How to approach this decision?

Now and I cannot stress this enough.

Investing is not a binary yes-no decision.

Decisions like this by its very nature involves predicting the future, and the future is inherently uncertain.

So when you approach a question like that, imagine it as you playing a poker game (and not a chess game).

There are no certainties here, its all about playing the probabilities, and how much you make when you win vs how much you lose when you're wrong (risk-reward).

What is the decision making process?

At a high level, there are 3 questions you need to think about:

1. Will REIT prices continue to go up?
2. What is the risk-reward for holding onto REITs?
3. What is the investor's risk appetite?

While (1) and (2) depend on external factors, (3) will vary for each investor.

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Let's walk though each of the 3 questions.

Will REIT prices continue to go up?

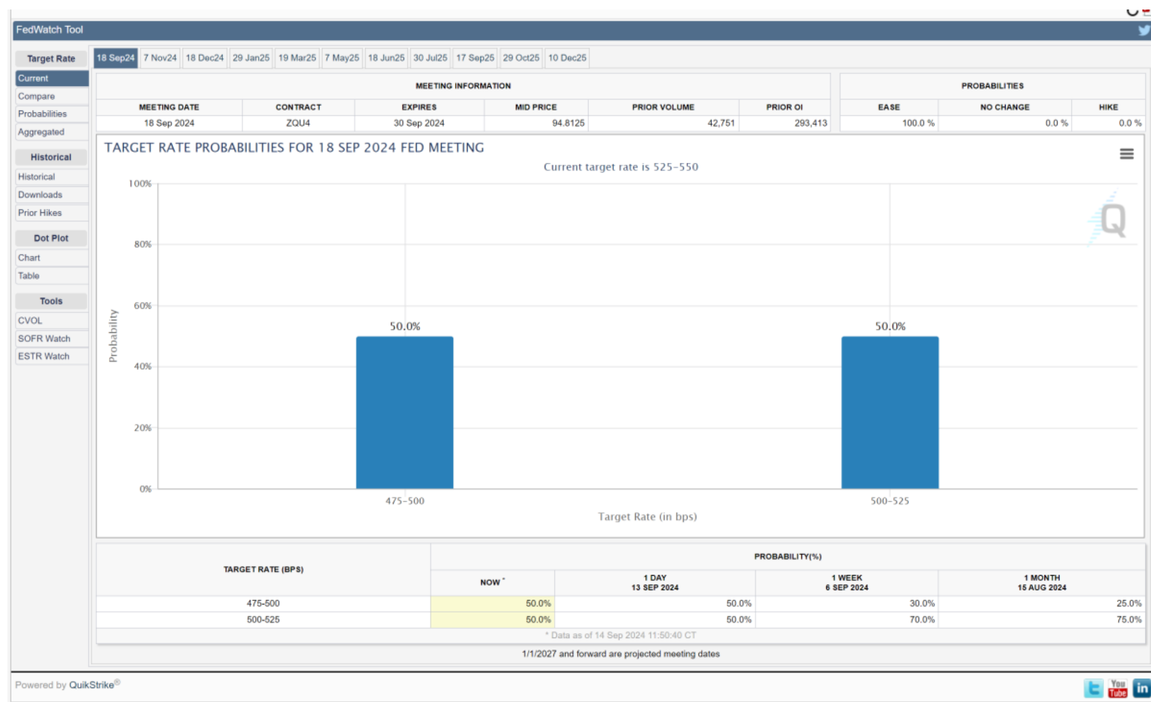
At a macro level, whether REIT prices will continue going up will depend on:

1. Interest rate outlook – how quick/deep are the interest rate cuts?
2. Recession – does the economy slow further or stay resilient?

Interest rate outlook – how quick/deep are the interest rate cuts?

This was what I wrote over the weekend for my portfolio update:

"We are 3 days to go to the next FOMC, and the market is pricing in 50-50 odds of a 25 bps vs 50 bps rate cut.



Typically the Feds like to give some guidance to markets on what they will do to avoid surprising on FOMC day, which makes this time somewhat unusual (although if you ask me it's not a bad thing - some "surprise" factor from central banks can be good to avoid complacency in markets).

The background here is that recent inflation and jobs data have not been weak enough to fully justify a 50 bps rate cut, and yet not strong enough to fully justify a 25 bps rate cut.

The added complexity is that this rate cut will take place 6 weeks before the US elections, so a 50 bps rate cut (sending markets to all time highs) could easily be interpreted as a political move to support the Democrats (and does not look good for Powell if Trump wins).

Because of that we're seeing 50-50 odds either way - although the market is expecting that if we see 25 bps this week we'll have 50bps in November once the elections are out of the way.

As shared, ***I think the Feds are slightly behind the curve on rate cuts here (especially due to monetary policy lag time)****, so once they start cutting they will have to cut fast and furious, so I generally agree with what has been priced in by the market."*

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	CME FEDWATCH TOOL - AGGREGATED MEETING PROBABILITIES									
MEETING DATE	275-300	300-325	325-350	350-375	375-400	400-425	425-450	450-475	475-500	500-525
9/18/2024	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	50.00 %	50.00 %
11/7/2024	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	3.96 %	96.04 %	0.00 %	0.00 %
12/18/2024	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	66.21 %	33.79 %	0.00 %	0.00 %	0.00 %
1/29/2025	0.00 %	0.00 %	0.00 %	18.00 %	82.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %
3/19/2025	0.00 %	0.00 %	56.00 %	44.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %
5/7/2025	0.00 %	48.22 %	51.78 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %
6/18/2025	22.67 %	77.33 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %
7/30/2025	64.00 %	36.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %
9/17/2025	91.69 %	8.31 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %

The Fedwatch tool's "Aggregated" view compares the rates implied by CME's Fed Funds futures with the current target rate range as set by the Federal Reserve. As such, it provides a view into the cumulative number of hikes or cuts that the market is pricing by a certain point in the future. This is provided in addition to the traditional "Conditional" view of probabilities, familiar to long-term users of the FedWatch tool.

Generally speaking, the above is what is priced into the market (2.5% in cuts over the next 12 months).

So if we see more aggressive rate cuts, there could be further upside for REITs.

If we see less rate cuts, there could be downside for REITs.

And I would say if the Feds cut in line with what is priced in, REITs probably have further upside in that scenario (the drop in interest expense alone will boost DPU).

Wildcard – will economic growth hold up?

Of course, things are never to simple.

Here's what I wrote in the weekend portfolio update:

"It's worth noting that the 2s10s yield curve has recently uninverted, and this has happened before every recession in the past 40 years (and did not trigger in the 1995 soft landing).

Coupled with many other recession indicators like Sahm rule, it suggests elevated risk of US recession in the months ahead.

Of course, there are many reasons why pre-COVID indicators are no longer valid (it is possible that the structure of the economy has changed post-COVID), and only time will tell.

But big picture wise, there is no doubt that global economic growth is slowing.

The million dollar question now is whether Fed rate cuts + whoever wins the US election in Nov will be enough to reverse the slowdown in the US/global economy."

My personal views?

The markets are now in a spot where the economy is weakening.

But the Feds are going to cut interest rates to juice the economy.

Will that be enough to offset slowing growth, and avoid a recession?

Throw in the uncertainty over the Nov US elections and what policies we'll see from the new administration, and this is not an easy question to answer.

My personal view here.

Is that just like how the Feds were behind the curve on inflation in 2021/2022.

Today they are behind the curve on unemployment.

And because of the time lag from monetary policy, I suspect they will have to do the opposite of 2021/2022, and cut aggressively once they start cutting.

So that's my view as of today, but for obvious reasons I could be wrong and my views will change as new data comes to light.

But on this basis, the macro environment looks positive for REITs (being the opposite of the past 18 months) - as long as we avoid a bad recession / market crash.

What is the risk-reward for holding onto REITs?

So the above is the broad macro analysis.

The second part is a more technical analysis – of how much you make when you're right, vs how much you lose when you're wrong.

For this question, I find it helpful to look at:

1. Technical analysis
2. Valuations

Technica Analysis - Charts for REITs

Let's look at the chart for the 4 REITs mentioned by the reader.

CICT looks bullish, in an uptrend, and having broken out of the 1.9 – 2.05 range:

Keppel DC REIT too is in an uptrend, and rapidly approaching the 2.30 resistance:

Mapletree Industrial Trust has had a sharp rally and is sitting at the 2.53 resistance, and a breakout from here would be pretty bullish:

CDL HT though, is still in a downtrend, but a break above 1.00 could signal a new uptrend:

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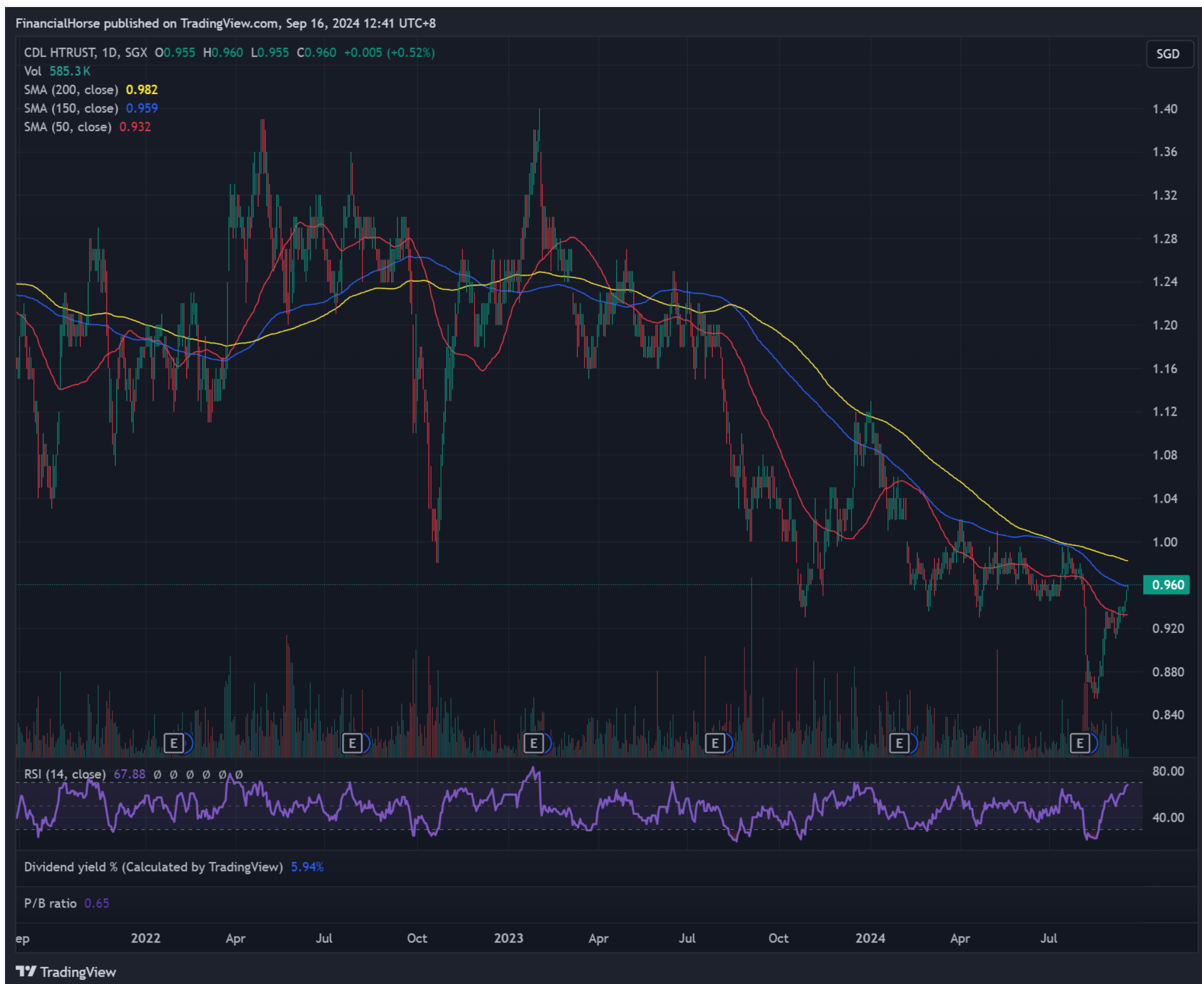

Just some additional REITs / BT not on the list.

Netlink Trust has been trending up on high volume, and broke out above the 91 resistance:

While MPACT broke out above the 1.36 support:

So save for CDL HT, generally speaking the charts for most of the REITs above looks bullish.

Many have broken out above key resistance levels, or are in the process of testing those resistance levels.

And most (save for CDL HT) look to be in an uptrend, with higher highs and higher lows.

Valuations of REITs

Valuations will differ for each REIT, but let's stay big picture here.

For CICT, annualised dividend yield today is 5.0%

Effective cap rate is 4.8%.

Whether this is cheap / expensive depends on where you think the Singapore 10 year yield will go in the months ahead.

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Some back of the napkin numbers.

I would say a 2.5% yield spread vs the 10 year SGS yield is fair value for CICT.

Working backwards:

10 year SGS yield	Fair value yield for CICT	Implied price of CICT	Upside (downside) – including dividend
3.5%	6.0%	1.81	(11%)
3.0%	5.5%	1.97	(4%)
2.5%	5.0%	2.17	5.0%
2.0%	4.5%	2.41	16%

Technical analysis wise the numbers generally check out.

Upside is probably around 2.35ish if it plays out.

Downside is 1.9ish if it goes there.

10 year SGS yield	Fair value yield for CICT	Implied price of CICT	Upside (downside) – including dividend
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2.5%	5.0%	2.17	5.0%
2.0%	4.5%	2.41	16%

What's the probability of each event?

If you ask me I would say the fair value for the 10 year is about 2.5%, which implies only 5.0% upside for CICT.

But the 10 year yield recently broke below 2.6%, and charts wise and macro wise it makes you wonder how low can the 10 year go.

The lower the 10 year yield goes, the higher the upside for REITs – as long as there is no recession / market sell-off.

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My personal views?

Valuations wise the REITs look fairly valued here simply because of the sharp drop in 10 year yields.

I know this is counter-intuitive after a 15% runup in REITs, but because the Singapore 10 year yield has gone from 3.5% to 2.4% in the span of 5 months, that alone would account for a huge jump in REIT prices.

Meanwhile technical analysis shows most of the REITs in an uptrend.

Looking at these charts, looking at the valuations, and looking at the macro setup – I would be inclined to hold onto my REITs here and continue to let them run.

Risk reward wise.

If I am right and aggressive rate cuts are coming, I think we see more upside for REITs (the 2.0% 10Y yield may be possible – implying 16% upside).

If the Feds cut in line with what the market is pricing in, I think we see mild upside for REITs (2.5% 10Y yield – implying 5% upside (largely from the dividend yield)).

If I am wrong and less rate cuts are coming, yes I will lose money but the loss I think is manageable relative to the upside if I am right (say 3.0% 10Y yield base case in this scenario, meaning 4% downside).

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10 year SGS yield	Fair value yield for CICT	Implied price of CICT	Upside (downside) – including dividend
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2.5%	5.0%	2.17	5.0%
2.0%	4.5%	2.41	16%

The wildcard scenario though is if the economy goes into recession / market risk off.

In that scenario it's not easy to call the downside risk, as it will depend on how bad the recession / risk off is.

Risk appetite - How much do you have in REITs? And your risk appetite / investment goals / time period?

Which brings us to the final question – individual risk appetite.

Needless to say if are levered to the gills with 150% of your portfolio invested in REITs, your ability to stomach risk is very different from an investor with 30% in REITs, no leverage and healthy cash buffers.

Regardless of what the charts / analysis says, you need to always account for the possibility that you are wrong.

Gun to my head I would say REITs may have more room to run, but the reason why I can take this bet is because even if I am wrong, I am sufficiently diversified in my portfolio, and I have enough cash on the sidelines, that I can take the loss.

If you don't have a high risk appetite, I would say you want to set a tight stop loss to protect your profits, and if price dips you can sell a portion of your REITs to lock in profits.

If you have a healthy risk appetite, as shared I am inclined to let the REITs continue to run for now given favourable macro, trend, and valuations, while being very careful to watch for data indicating a recession / market sell-off.

Closing Thoughts – Let your winners run?

One final thought from me – was the comment from the reader that he wants to take profit in the REITs that are doing well, and average into CDL HT:

I have some REITs counters like CICT, Keppel DC Reits and MIT which are making profit of about 20% and CDL losing about 15%.

I intend to hold on to CDL and to buy more if it drops further."

This struck me as counterintuitive.

As you would probably have heard of the famous saying:

Let your winners run.

Or

Losers average losers.

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Now I understand the logic in that the winners are looking overvalued and taking profit makes sense, while the losers are "cheap" and have more room to run.

But a cardinal sin in investing is cutting your winners too early and adding to losers, so I really wanted to flag this risk.

In many cases the winners can go higher than you expect, while the losers can stay low for longer than you expect.

Now of course there's some nuance in that I don't know how exactly the CDL position is sized relative to the other REITs, and this will require a deeper analysis into CDL HT (as it may indeed offer value on a fundamental basis).

But in my experience this is one of the biggest mistake that investors (myself included) make, and it's worth bearing this in mind when deciding which names to take profit in / add to.

Closing thoughts… for real

So there you have it!

A very lengthy answer to a deceptively simple question.

Again, there's no right or wrong with these things, and its all about playing the probabilities.

I've shared my thought process above and I hope its helpful for you.

But I would love to discuss any follow up questions below, and please feel free to disagree with me!

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