

Company overview

European Investors Incorporated (EII) was founded in 1983 as a family office for European clients investing in the US across asset lines including equity, fixed income and real estate. It's now an independent employee-owned investment management boutique, employing more than 50 people across New York, Amsterdam, Singapore and Munich offices and has become one of the world's leading specialist real estate managers.

EII has been investing in US equity and fixed income markets since 1983, the US direct real estate markets since 1985 and US real estate equity markets since 1987. It began investing in global real estate securities in 2000. EII believes its strength comes from its employees through their specialised skills, experience and entrepreneurial spirit, enabling EII to capitalise across capital markets, real estate and asset management.

Real estate related investments currently represent over 90% of EII's assets under management. Its real estate expertise is focused on domestic, international and global real estate securities, as well as on US direct real estate. EII's clients include European and US families (including Asian and Canadian), corporations, public funds, endowments, foundations, (banks) and other investment professionals. It manages funds hosted in the US, Ireland, the UK, Luxemburg, Austria and Australia and its clients benefit from the flexibility of being able to choose between individual accounts and publicly traded combined funds.

Investment philosophy and style

EII's investment management philosophy centres around its belief that superior risk-adjusted returns can be achieved by investing in a portfolio of high quality real estate companies, capable of sustainable and predictable long-term cash flow growth. In assessing the merits of potential investments, EII places a high priority on the quality of management, depth of the team, its vision for the company, the quality of the real estate assets and competitive advantages. It strives to invest in companies managed by real estate professionals who understand the importance of asset rotation and believe the best property companies/REITs are managed by professionals who combine effective real estate decision-making skills with understanding the need to create shareholder value.

EII's Global Property investment strategy is opportunistic and focuses on investing in countries and sectors with the greatest growth potential, where economic and real estate fundamentals are most attractive. It places emphasis on identifying stocks that have been mispriced by the market and are well-managed and well-positioned to capitalise on the trends in their respective regions. EII's Global Property total return target is 10-12% annualised over a market cycle.

Investment process

EII estimates the total universe of real estate stocks is made up of more than 800 companies. This greatly exceeds the number included in recognised indices (eg around 320 securities in EPRA Global) and although this is improving, EII believes this illustrates how quickly these indices are evolving.

The first stage of EII's investment process involves screening this total universe. Its investment team uses two levels of screening to determine the investable universe for the product. In the first stage, it screens out all stocks below US\$250 million, which it believes is an appropriate liquidity cut-off for a global fund. The second screen, which leads to EII's stock focus list, applies qualitative tests to screen out stocks that have undesirable characteristics, for example a company may look like a meaningful investment but may require investing in a market with insufficient property rights. Stocks that have been excluded following this screening are also regularly monitored to ensure emerging opportunities are identified and reconsidered for investment as soon as possible.

EII's portfolio managers determine areas of priority in a country (in Europe and Asia) and sector standpoint, considering the information gathered and communicated by the analysts. Its senior management also participate in the investment process, primarily through a Global Advisory Committee, weighing in on regional allocation considerations/decisions. The Committee is macro focused, and doesn't discuss or influence stock selection.

EII's investment analysts dedicate 90% of their time to fundamental, bottom-up company level research and 10% to sector and country level analysis. Analysts focus their efforts on building comprehensive financial models for companies in its target universe, using Dividend Discount Model (DDM), Discounted Cash Flow (DCF) and Net Asset Value (NAV) models. EII also carries out a peer review process where each analyst reviews the models with the help of another analyst to ensure a measure of quality control is followed. In addition, the portfolio managers review all models periodically to reassess market assumptions and overall analytical quality.

This bottom-up analysis aims to provide EII with a variety of valuations on which to base investment decisions. After extensive review of a company, the analysts, in collaboration with portfolio managers, determine a target price and entry point for investment. Security weights reflect the conviction level of the portfolio managers, with consideration given to liquidity and benchmark weight. This is a dynamic and iterative process.

From the top-down or macro perspective, EII focuses on factors it believes have a substantial impact on the real estate sector. For most of the countries it considers, EII believes general economic statistics will have the following effects on the development of the real estate sector.

- **Job creation** – employment statistics are of great significance for all aspects of the real estate market.
- **Retail sales** – affect the retail property sector directly but also have implications for office demand and residential sales.
- **Interest rates** – while interest rates are of crucial importance for such a capital-intensive industry, property share prices are often negatively correlated with the bond markets.
- **Industry specific indicators** – land prices, supply/demand, construction industry, housing market statistics and commodity price levels for materials used (copper, steel, cement and lumber) are important in assessing the future of the sector.
- **Relative valuation** – if shares are trading at discounts to NAV it can be cheaper to buy real estate through the public markets rather than the private and these companies may represent attractive buying opportunities.

EII builds portfolios from the bottom up and although it's conscious of benchmark weights (ie for stocks, sectors, countries and regions) it doesn't build portfolios using the benchmark as the starting point.

Reason Advance selected EII

We selected EII as a high conviction, benchmark unaware manager within the Property Securities portfolio, having managed listed property trust investments since 1987. We recognise the value of the team's broad experience, headed by co-portfolio managers Al Otero and James Rehlender, who have significant direct and listed property industry experience.

We view EII's portfolio construction process as unique and differentiating, based on a regional approach, allowing it to extract and capitalise on independent market inefficiencies. A key differentiator is EII's use of different valuation techniques based on the idiosyncrasies of each of these regions. It targets a significantly wider stock universe, which is not constrained by regional indices, increasing the opportunity set for the identification of mispriced securities to add value. In a blended portfolio the manager's higher tracking error process provides for a greater diversity of alpha opportunities across the global listed property market.

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