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What do Amazon, Safeway, Walmart, Sobeys and Shoppers Drug Mart have in common?

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"Everybody who has ever invested during our darkest days has ultimately been rewarded. There's no reason to think this time is different."

Warren Buffet

The first thing they have in common is that they all reported record sales over the few last weeks. The shares of Walmart have hit all-time highs today while the whole market slumped (the DOW is now down over 34% from its recent highs).

The second thing they have in common is the fact that they are all anchor tenants in our REIT portfolio.

Over the last three trading days the REIT market, the core of our investment portfolio, has suffered considerable losses due to the panic selling caused by the spread of the coronavirus. The losses in the REIT sector have now reached the same level as the losses in the overall market (around 30%) even though, until early last week, they were the best performing asset class in North America. The baby has officially been thrown out with the bath water.

The first two paragraphs highlight the paradox of today's situation – that key tenants are experiencing record sales, yet the shares of the owners of their buildings are dropping. Fundamentals have been replaced by negative emotion.

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Crombie REIT, one of our core holdings, derives over 80% of its income from Safeway (owned by Sobeys in Canada) as they are the main tenant in their properties across the country. Yet, investors began behaving as though Safeway was about to stop paying its rent, despite record sales, bringing Crombie stock down over 35% from its recent highs.

Nathaniel Rothschild, who made his fortune during the Napoleonic Wars, famously quipped “Buy real estate when there is blood in the streets” and then added “…even if it is your own”.

Despite the macabre connotation, what his statement really means is that, during dark times, reason and common sense is impossible to find - emotion rules and people are willing to sell the best of assets for a fraction of their replacement cost. Smart and brave investors should take heed.

Do we really believe that Safeway, Sobeys or Walmart will close their doors for good or that Amazon will vacate its e-commerce fulfillment centers? (like the ones owned by Summit Industrial or WPT REIT) - all of this during the time of record profits? Furthermore, Amazon, Kruger and Walmart all announced additional hiring to a combined total of 250,000 extra staff to help fulfill online orders and stock empty shelves in supermarkets.

With that in mind, together with our REIT analyst Mark Rothschild, today we reached out to some of the CEOs of the REITs that we own – Crombie, Dream Industrial, Summit and First Capital.

They all shared our sentiment about asset mispricing and reinforced the strength of their convictions by sharing the details of their balance sheets, tenants, property values etc. The conclusion of our discussions was they are all well capitalized and do not foresee any financial difficulties even in a scenario when some small tenants may close their doors. To quote the CEO of First Capital Realty, “we would do well even if all restaurants in our locations went out of business indefinitely”. First Capital derives the majority of its income from Sobeys, Loblaws and Walmart.

The reasons for owning our chosen REITS before, during and after the coronavirus crisis:

Even though the upcoming months will be challenging for all industries and the economy as a whole, the REITs we own were in a solid position going into the crisis - with record earnings, high occupancy rates and strong balance sheets. In fact, the companies that make up the REIT index are the strongest financially they have been since the creation of REITs in 1963 in US and 1993 in Canada.

The reasons we own the best and most well capitalized companies in the real estate sector haven't changed in recent days and this is something important that we need to remember in the coming months and beyond. We chose the REITs in our portfolios carefully and with an eye on modern economy demands. We looked for companies that touch every sector of modern life – cell towers, e-commerce fulfillment centers, residential properties and data centers are the core of our portfolios. All of these industries are not only the linchpin of today's economy but also are thriving today during these uncertain times – e-commerce fulfillment centers are struggling to meet the demand of increased online customer activity, mobile networks are stretched to the limit and many companies find themselves with inadequate computer servers to support the new remote access workloads (data centers house servers). All of these are positives for the REITs that we own.

With more than 70% of a REIT's total return coming from the compounding of monthly income it is important to stay invested and allow real estate to do what it was designed to do – provide stable ongoing income and capital appreciation over time. Trying to trade in and out of the REIT sector based on short term turbulences is not only detrimental to returns but can effectively exclude an investor from market recovery, which in today's case, can be very fast once the spread of the virus levels off.

Despite all the upheaval and fear that grips our lives today, one thing is still constant (and even more significant today) - we still need a roof over our heads to sleep, work or just unwind. Real Estate and the REITs, although caught in the market crash today, will continue to be important pillars of our lives and the economy of the future.

Stay healthy and well informed,

Your KWM Team