Charter Hall Property Securities Management Limited
ACN 104 512 978 AFSL 238349
office@charterhall.com.au www.charterhall.com.au/maxim

Charter Hall Maxim Property Securities Fund

Report December 2018

Charter Hall Maxim Property Securities Fund	Month %	3 Months %	1 Year % p.a.	3 Years % p.a.	5 Years % p.a.	10 Years % p.a.	Since Inception % p.a.*
Growth	+0.85	-1.78	-0.08	+5.42	+9.34	+9.61	+1.37
Income Return	+0.84	+0.84	+3.41	+4.37	+4.94	+3.53	+3.73
Total Return (After Fees but Before Tax) **	+1.69	-0.93	+3.33	+9.78	+14.27	+13.15	+5.09
S&P/ASX 300 A-REIT Accumulation Index	+1.73	-1.71	+3.27	+7.55	+12.53	+10.66	+3.91
Value Add	-0.04	+0.78	+0.06	+2.23	+1.74	+2.49	+1.18

*Fund inception date October 2005. **Please note the Fund's management fee was reduced on 16 May 2014. The Fund's after fees but before tax performance only reflects the new management fee from this date.

Past performance is not an indicator of future performance.

QUALITATIVE RATING

QUANTITATIVE RATING

Overall rating out of 123 Equity Australia Real Estate funds as of 30 September 2018.

2018 IN REVIEW

2018 will be remembered as a transitional year for the A-REIT sector, as the duel tailwinds of rising asset prices and falling interest rates, which have underpinned sector performance for a number of years now, abated and even turned into headwinds. Until recently, these tailwinds have had a positive effect on most of the securities in the A-REIT sector, regardless of their underlying operational performance. With these tailwinds now subsiding we are starting to see more pronounced performance amongst different A-REIT sectors and securities based on underlying sector fundamentals and security specific issues.

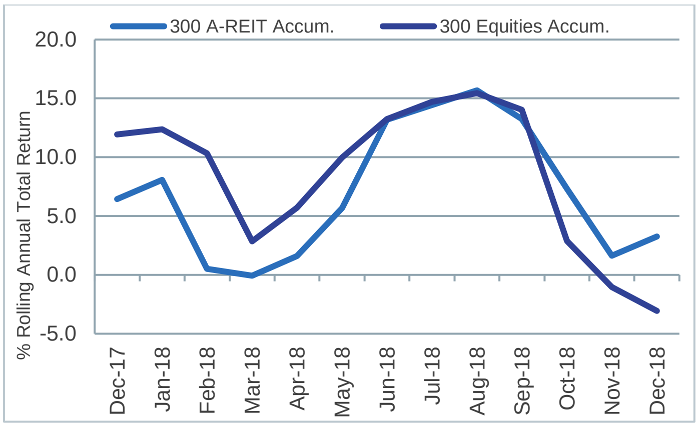
The year will also be remembered for the elevated levels of corporate activity in the A-REIT sector, which included the sale of Westfield Corporation (WFD). At one point there were no fewer than seven concurrent takeover offers, including Investa Office Fund (IOF), Gateway Lifestyle Group (GTY), Property Link (PLG), Folkestone (FLK), Asia Pacific Data Centres (AJD), Centuria Industrial REIT (CIP), and Australian Unity Office Fund (AOF).

The 2018 A-REIT sector performance can be viewed as a tale of two halves, with the sector underperforming the broader market in the first half of the year, followed by strong outperformance in the second half. This performance largely reflects a change in sentiment around US economic growth and the Fed's policy on US interest rates. Overall the S&P/ASX 300 A-REIT Accumulation Index finished the year (to December 2018) in positive terrritory, up 3.3%, beating the broader Australian equities market by 6.4%, which declined 3.1% (Figure 1).

Against a backdrop of strong economic growth in the US, the Fed continued to lift rates during 2018, taking the official rate to 2.5% by December end, up 1.0% over the year. However, it became very evident by December that the likelihood of future interest rate rises in the US were in the short-term moderating. Despite the recent Fed 'Dot Points' survey, which suggests three more interest rate hikes this cycle, the slope of the yield curve now implies there may not be any more interest rate rises in the US in the short term. These expectations are also reflected in the weaker outlook statements from

Figure 1: A-REITs vs. Equity Performance

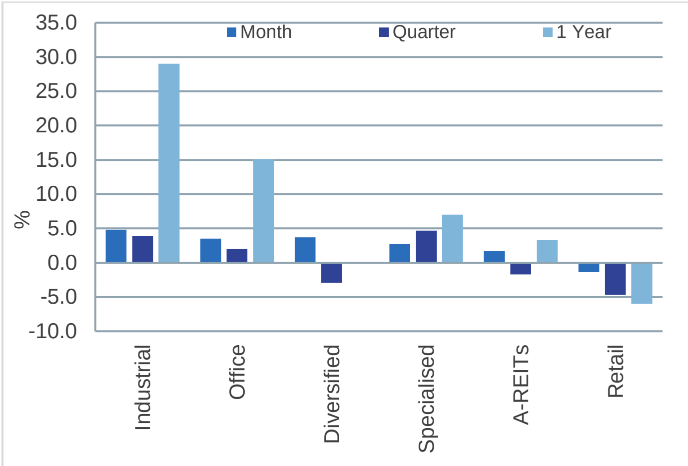
12 months to 31 December 2018



Source: IRESS

Figure 2: A-REIT Sector Performance

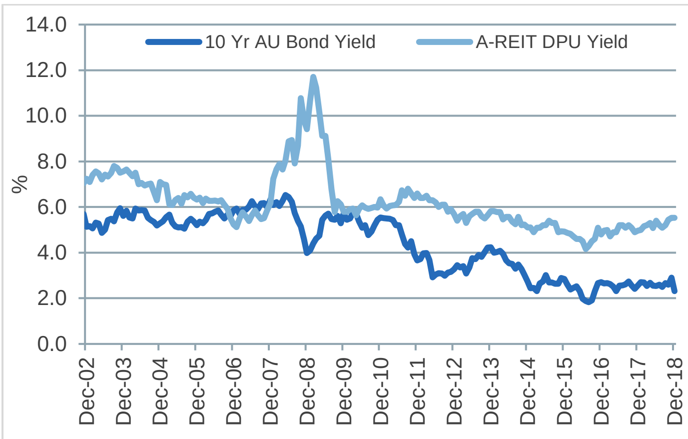
12 months to 31 December 2018



Source: Bloomberg

Figure 3: A-REITs Sector DPS Yields vs. 10 Year Bond Yields

2002 – 2018



Source: IRESS

US companies during the last reporting season. At that time companies reasoned that recent increases in interest rates, coupled with a diminishing positive impact from US tax cuts and likely issues from the US trade war with China, would lead to a more challenging outlook. In fact, some economic commentators are calling a US Recession in 2020, which would have seemed highly unlikely only a year ago.

These conditions have led to volatile equity markets globally, especially in the later part of the year, with the S&P500 range trading approximately +/- 25% since the start of October and the VIX Index trading at elevated levels.

Locally, the Australian economy continues to chug along, with annualised GDP of 2.8%, and an unemployment rate of only 5.1%. However, there are signs that this growth may start to come under pressure driven by a slowdown in residential construction as tighter credit restrictions take hold. Further pressure on the housing secor may also arise from a change in leadership to a Labor Federal Government and their proposed changes to negative gearing.

The Reserve Bank (RBA) continues to maintain its official interest rate at 1.5%. The last move being a 25bp reduction in August 2016. Nevertheless, Australian 10-year bond rates ended the 2018 year at 2.3%, having peaked at 2.9% earlier in the year. It seems the combination of a weaker US outlook and some home-grown issues may lead to a benign outlook for rates domestically.

SUB SECTOR PERFORMANCE

The divergence of A-REIT sub-sector performance during 2018 certainly reflected the underlying performance of the respective direct property markets.

At the A-REIT sub-sector level the best performers were Industrial A-REITs which returned +29.0%, Office A-REITs with +15.1%, and Specialised A-REITs with +7.0%. While the worst performers were Retail A-REITs with -6.0% and Diversified A-REITs with 0.1%.

The industrial sector continues to undergo its relative re-rating vs the other traditional core sectors of office and retail given its perceived link to e-commerce and the growing need for warehouse space. Goodman Group (GMG) dominates this space in Australia, and with its global portfolio, is often seen as the best play on this thematic. It is clear from our research that offshore investors are more in tune with this thematic than domestic investors, which explains the strong presence of offshore investors on GMG’s share register.

The office sector continues to perform strongly in Australia, with the latest Property Council/IPD data in September showing total returns for office outperforming other key direct property sectors. This strength is further supported by a recent report from Colliers which shows low vacancy rates in Sydney and Melbourne CBD’s of 4.6% and 3.6% respectively. Groups such as Dexus (DXS) have benefited from these tight markets, as evidenced by its recent strong portfolio revaluation and NTA uplift.

The retail sector is currently facing the duel headwinds of cyclical and structural downturns. While the October ABS data showed a slight increase in the annual sales growth rate to 3.0%, growth in retail sales remains at more subdued levels than those recorded before the Credit Crisis. Across the A-REIT sector we continue to see weak portfolio fundamentals especially re-leasing spreads and more recently a number of A-REITs, such as Vicinity Group (VCX) and Stockland (SGP), have sold retail assets below book values.

The housing market has quickly turned down with national dwelling prices now 1.3% lower over the year to December, as recorded by Core Logic. The performance is significantly worse for Sydney -10.0%, and Melbourne -9.1%. Both markets recorded the largest increases during the last boom struggled with poor affordability. A number of factors, including tighter credit availability, are pointing to continued weakness in the sector. In the A-REIT sector we have already started to see earnings downgrades for residential developers like Villaworld (VLW) and it will be interesting to see how the larger and more diversified A-REIT developers, Mirvac (MGR) and Stockland (SGP), withstand current conditions.

QUARTERLY SECTOR REVIEW

Over the December quarter, A-REITs outperformed Australian equities, with the S&P/ASX 300 A-REIT Accumulation Index delivering -1.7% compared to -8.4% for Australian equities.

At the A-REIT sub-sector level, Specialised A-REITs were the best performer with a return of +4.7%, led by National Storage REIT (NSR +7.7%). The next best sub-sector was Industrial A-REITs which returned +3.9%, followed by Healthcare A-REITs with +3.5%, Office A-REITs with +2.0%, Residential A-REITs with 0.0%, Diversified A-REITs with -2.9% and Retail A-REITs with -4.7%.

The three best performing securities in the S&P/ASX 300 A-REIT Accumulation Index for the December quarter were SCA Property Group (SCP +9.2%) following its recent $259 million capial raising and portfolio acquisition, Charter Hall Retail (CQR +8.9%) following a noticeable improvement at the August result, and BWP Trust (BWP +8.3%) on no material news flow. Interestingly, these are all retail sector securities, albeit non-discretionary retail, which despite a weaker retail backdrop, have performed well.

The three worst performing securities for the December quarter were Unibail Rodamco Westfield (URW -24.2%) as investors balked at weaker retail data offshore and questioned the long term listing potential on the ASX as a CDI security, Stockland (SGP -12.0%) with negative sentiment surrounding both housing markets, and Cromwell Group (CMW -5.2%) as investors continue to struggle with the complexity and strategy of the business.

MONTHLY SECTOR REVIEW

For the month of December, the S&P/ASX 300 A-REIT Accumulation Index returned +1.7%, outperforming the Australian equities market (S&P/ASX 300 Accumulation Index), which returned -0.2%, on what was a volatile month for the ASX.

December featured announcements from a number of A-REITs regarding portfolio revaluations, and it was clear from those announcements how well office assets are performing relative to retail assets. Retail A-REITs, Aventus Group (AVN) and SCA Property Group (SCP) both announced little or no change to their portfolio values, while office A-REIT Dexus (DXS) announced a healthy 30bp tightening in its portfolio cap rate.

In M&A news, the Property Link (PLG) board accepted the $1.20 takeover offer from ESR Real Estate (Australia), which is open to acceptances until 31 Jan 2019. Elsewhere, Investa Office Fund (IOF) and Asia Pacific Data Centres (AJD) were removed from the ASX, following their successful takeovers from Oxford Properties and Next DC (NXT) respectively.

In what may be the first of further negative announcements for residential developers, Villaworld (VLW) advised the market that due to the deterioration in market conditions it could no longer provide guidance for FY19 and expects 1H19 NPAT of $16m - $17m, which implies a 15-20% downgrade.

Charter Hall Long Wale REIT (CLW) undertook a $125 million equity raise at $4.05 to fund 27 agri-logistics properties, for a total consideration of $207 million with an acquisition price reflecting a 7.35% weighted average capitalisation rate. The acquisition continues the diversification of the A-REIT sector into more non-core sectors.

SECTOR VALUATION

As at the end of December, the A-REIT sector was trading on a FY19 estimated distribution yield of 5.5%. While low by historical levels, this is a function of the low interest rate environment at present.

A-REIT distribution yields continue to look attractive relative to interest rates, with near record spreads. Currently, the A-REIT sector distribution yield offers a 400 bps premium to the RBA Cash Rate and a 320 bps premium to 10 Year Bonds (Figure 3).

The A-REIT sector is also currently trading on a 18.5% premium to net tangible assets (NTA), which on face value looks expensive. However, this becomes a 3.6% discount to NTA when Goodman Group (GMG) and Charter Hall (CHC) are excluded, both of which derive a substantial portion of their earnings from funds management. Therefore, on this basis A-REIT valuations look reasonable.

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FUND PERFORMANCE REPORT

December 2018

For the month of December 2018, the Fund returned +1.69% (on an After Fee but Before Tax basis), marginally underperforming the Fund's Benchmark (S&P/ASX 300 A-REIT Accumulation Index) return of +1.73% by 0.04%.

Positive contributions to returns during the month came from the Fund's zero holdings in Unibail-Rodamco-Westfield (URW -9.9%) and holdings in Industria REIT (IDR +4.2%) and Convenience Retail REIT (CRR +4.0%).

Negative contributions to returns came from zero holdings in Dexus (DXS +4.1%) and Charter Hall (CHC +8.5%) and a holding in Lifestyle Communities (LIC, -4.2%).

December Quarter 2018

For the December 2018 Quarter, the Fund returned -0.93% (on an After Fee but Before Tax basis), outperforming the S&P/ASX 300 A-REIT Accumulation Index return of -1.71% by 0.78%.

Positive contributions to returns during the quarter came from the Fund's zero weight exposure to Unibail Rodamco Westfield (URW -24.2%), and overweight positions in Charter Hall Education Trust (CQE +6.4%), Australian Unity Office Fund (AOF +3.4%), and Vital Harvest Freehold Trust (VTH +4.2%).

Negative contributions to returns during the quarter came from zero weight holdings in Vicinity Centres (VCX +2.2%) and Dexus (DXS +3.1%), an overweight position in Carindale Property Trust (CDP -8.9%), and a part period holding in Charter Hall Group (CHC +5.9%).

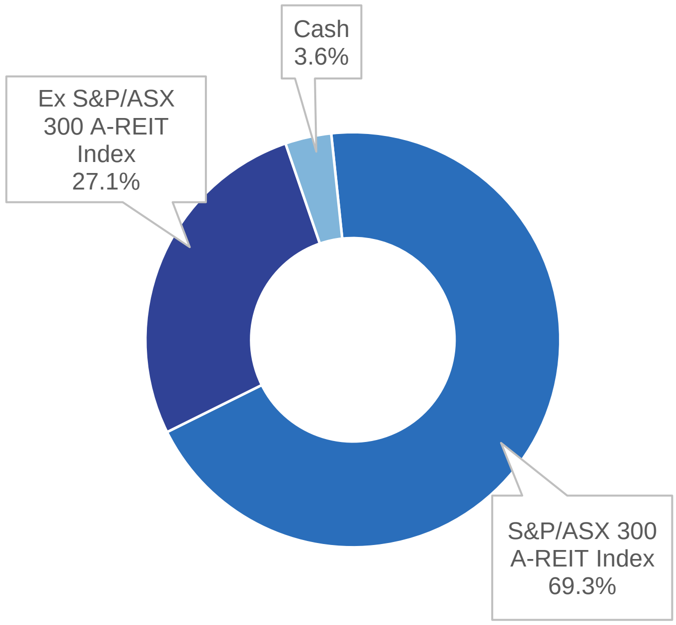
Year to December 2018

For the 12 months to December 2018, the Fund returned +3.33% (after Fees but Before Tax), outperforming its benchmark return of +3.27% by 0.06%.

The table below highlights the Fund's key active positions, which have contributed most to its outperformance over the year to December 2018.

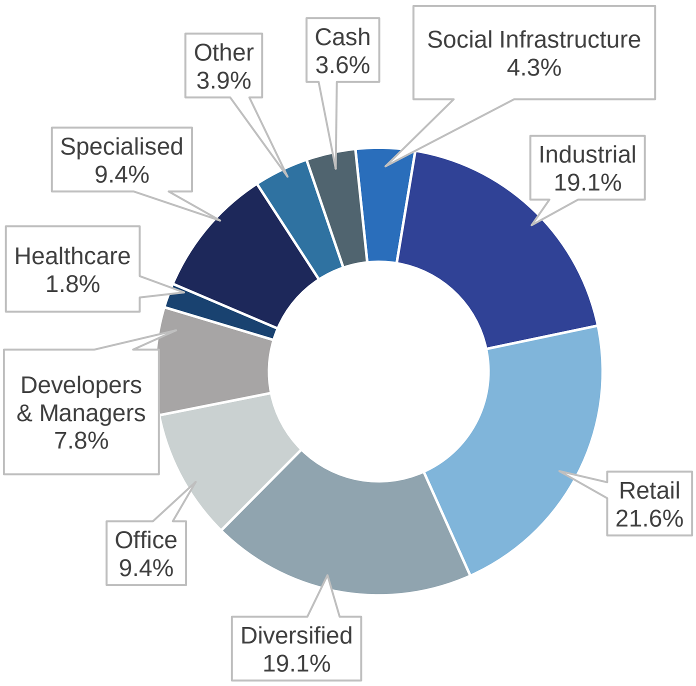
FUND ASSET ALLOCATION

As at 31 December 2018



FUND SECTOR SPLIT

As at 31 December 2018



Please note: Numbers in the graphs may not add up to 100 due to rounding.

Charter Hall Maxim Property Securities Fund

Unibail Rodamco Westfield (URW)	Underweight
Industria REIT (IDR)	Overweight
Australian Unity Office Fund (AOF)	Overweight
Charter Hall Education REIT (CQE)	Overweight

At the end of December, the Fund's investments comprised 20 ASX listed securities totaling 96.4% of the portfolio, 11 of which were constituents of the S&P/ASX 300 A-REIT Index, with the remaining 9 holdings being non-index securities. The balance, 3.6% of the portfolio, was held in cash/liquid investments.

A December 2018 Quarter distribution of 0.7555 cents per Unit (paid to investors on 7th January 2019), took total distributions for the 12 months ended 31 December 2018 to 2.8982 cents per Unit.

OUTLOOK

Looking forward to 2019, we expect elevated volatility in equity markets to continue as they readjust to a less positive outlook for the US economy, US tariff trade wars, and a likely conclusion to Fed tightening this cycle. We believe this may pose choppy performance for both bond rates and A-REITs, whose performance are often linked.

Equities and A-REITs locally will need to also contend with a Federal election, and should Labor win, we can assume changes to both dividend imputation and negative gearing. These changes could be negative for sentiment in the broader market and for A-REITs and the residential sector.

For A-REITs we expect a continuation of moderate total returns in 2019, underpinned by solid and reliable cashflows. At present there don't appear to be any major risks on the horizon, albeit volatility in bond rates. The A-REITs should continue to deliver relatively attractive returns, underpinned by sound performance from commercial property.

TOP 5 ACTIVE OVERWEIGHTS

By Portfolio Weight

Australian Unity Office Fund (AOF)
Vital Harvest (VTH)
Rural Funds Group (RFF)
Industria REIT (IDR)
Charter Hall Education Trust (CQE)

FUND OVERVIEW

As at 30 November 2018

Status	Open
Fund Maturity	Open Ended
Investment	Primarily A-REITs
Investment Horizon	3-5 Years
Distribution Frequency	Quarterly
Fund Inception Date	October 2005
Pricing	Daily
Buy/Sell Spread	0.25%/0.25%
Total MER	0.95% up to $50m Plus 0.85% >$50m
ARSN	116 193 563
APIR Code	COL0001AU

PLATFORMS

Asgard
Colonial First State FirstWrap
BT Panorama
BT Wrap
HUB24
Macquarie Wrap Solutions
Netwealth
IOOF Pursuit
Powerwrap
Symetry
uXchange

We also believe the A-REIT sector will remain favourably supported by continued offshore demand for Australian property.

We anticipate corporate activity in the A-REIT sector to continue, given an environment of cheap debt, lower premium to NTA's, and a low Australian dollar.

Sector wise, we expect a continuation of the current themes of stronger office/industrial fundamentals and weaker retail/residential development fundamentals.

We believe the Charter Hall Maxim Property Securities Fund is well placed to weather the macro-environment, given its high conviction and active strategy which allows us to over/under weight specific sectors. At present the portfolio has large underweight positions to Retail A-REITs and Diversified A-REITs and a large overweight position to Specialised A-REITs which own assets such as childcare centres and farms. We believe these exposures will deliver superior performance to the broader A-REIT sector in the year ahead.

Charter Hall Maxim
Wins Industry Leadership Award

In December 2017, Charter Hall Maxim (formerly Folkestone Maxim) won the inaugural Financial Standard Investment Leadership Award for Australian Listed Property.

The Financial Standard award recognises *"investment strategies that showcase all the qualities investors - whether they be advised or self directed - are looking for in a manager".*

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The ***Morningstar Rating*** *is an assessment of a fund's past performance – based on both return and risk – which shows how similar investments compare with their competitors. A high rating alone is insufficient basis for an investment decision. Charter Hall Maxim Property Securities Fund received a 5-Star Overall Morningstar Rating™ as at 30-09-2018.© 2018 Morningstar, Inc. All rights reserved. Neither Morningstar, its affiliates, nor the content providers guarantee the data or content contained herein to be accurate, complete or timely nor will they have any liability for its use or distribution. Any general advice or 'class service' have been prepared by Morningstar Australasia Pty Ltd (ABN: 95 090 665 544, AFSL: 240892) and/or Morningstar Research Ltd, subsidiaries of Morningstar, Inc, without reference to your objectives, financial situation or needs. Refer to our Financial Services Guide (FSG) for more information at www.morningstar.com.au/s/fsg.pdf. You should consider the advice in light of these matters and if applicable, the relevant Product Disclosure Statement before making any decision to invest. Our publications, ratings and products should be viewed as an additional investment resource, not as your sole source of information. Past performance does not necessarily indicate a financial product's future performance. To obtain advice tailored to your situation, contact a professional financial adviser.*

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Charter Hall Maxim Property Securities Fund

Contact Us

Winston Sammut
Head of Listed Securities
Winston.sammut@charterhall.com.au
T: 0411 401 576

Lula Liossi
Investor Relations Manager
Lula.liossi@charterhall.com.au
T: 0408 958 755

Monica Hood
Business Development Manager
Monica.hood@charterhall.com.au
T: 0431 478 780

Harry Horwitz-Rourke
Distributions Manager
Harry.rourke@charterhall.com.au
T: 0409 488 655

Charter Hall Property Securities Management Limited

ACN 104 512 978
AFSL 238349
office@charterhall.com.au
www.charterhall.com.au

Sydney Office
Level 20, No.1 Martin Place
Sydney NSW 2000
T: +61 2 8651 9000

Melbourne Office
Level 12, 570 Bourke Street
Melbourne VIC 3000
T: +61 3 9903 6100