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DrobnyGlobal Guest Research

From time to time, Drobny Global Advisors will distribute the thoughts and views contributed by our hedge fund / money manager client base, and by some of our friends. The aim, like our conference and research, is to help our clients make money by sharing smart ideas from smart guys. If you have any trade ideas you would like to share, discuss, generate controversy, shake up tree, test the waters & reactions; please get in touch to discuss the process. – Andres Drobny

From Paul Schulte of Taking Stock llc:

Trade Idea: Long Asian Property against US Property

This trade is an extention of the concept of overweighting Asian stocks and underweighting the US. But, with an added kicker based on the added divergence in property performance between the two regions.

After a five-year bear market in property, asset reflation throughout Asia is finally causing a stir in property prices. Residential rents and prices finally have stabilized throughout Asia almost without exception. Trends in office rents, however, are still patchy.

The most mature bear market in Asia is in Taiwan. The property market collapsed in 1992 and is only now stabilizing. In addition mortgage rates in Taipei are at 2.7%. Mortgage rates in Hong Kong and Singapore are at similar levels. There has been a sustained recovery in property prices in Thailand for about a year, and a similar story is developing in Indonesia.

With very little supply – and lots of pent up demand -- the makings of a long-term recovery in property seems intact. And, rental yields look attractive. In HK, for example, they are running at around 5%. Compared to a 3% mortgage rate, you almost *can't afford not to own!* Further price falls are built into this funding equation.

One liquid way to gain exposure to a potential recovery in Asian property is via publicly listed property companies. They seem under-owned and undervalued. Note, that P/Es are an inappropriate valuation mechanism for property companies. On an NAV basis, Indonesia is the cheapest and Thailand the most expensive. Taiwan, Hong Kong and Singapore are trading at discounts to NAV of about 15-30%. Indonesian property companies are trading at about 80% discounts to NAV, while Thailand is trading at NAV. We have intentionally not included and Chinese or Korean property prices in the portfolio. In both cases, those governments have implemented policies designed to slow down the amount of capital available for purchase or speculation in consumption/property.

Meanwhile, as a property prices collapsed in Asia, there has been the well know property 'bubble' in many Western countries. And, in contrast to Asia, rental yields in many countries, including the US, have fallen to very low levels, in many cases below 2%.

It's an open question whether the Western property 'bubble' will burst. But, given such dramatic differences in price performance over the past 5-10 years, at the very least there seems considerable potential for convergence between property prices in the Far East and in the West. That is, it seems a good bet that, in a global reflationary environment, convergence would occur through Asian property catching up to the West (although strong reflation, resulting in higher rates, might actually produce a pop in the bubble in the West). And, if deflation re-emerges, Western property prices sure seem more exposed.

The problem with the trade is finding a vehicle to express the property short in the West. That's where US mortgage financials come into the picture. They funded a substantial bull market in US property prices as prices were collapsing in Asia. Moreover, the extent of leverage in this sector could well be underestimated. And, their stocks are highly liquid and tradeable.

Execution: ***Go long Asian Property companies and sell US mortgage-related financial institutions.***

The specific companies we recommend for the trade are:

Long: Sun Hung Kai (16 HK); Cathay Real Estate (2501 TT); Hung Poo (2536 TT); IOI (IOI MK); Ayala Land (ALI PM); City Development (CIT SP); Summaracon Agung (SMRA IJ); Land and Houses (LH TB); Hong Kong Land (HKL SP).

Short: Washington Mutual (WM); Countrywide (CFC) Fannie Mae (FNMA).

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Andres Drobny comments: This trade seems to fit especially well in a portfolio that is long the front ends of the interest rate markets. Surprisingly large rate hikes would add to the case for a correction in relative property market performance in many of the Anglo Saxon countries.