SHOJIN

PROPERTY PARTNERS

REAL ESTATE VERSUS INFLATION

SPECIAL REPORT

There can be no doubt that a single issue is weighting disproportionately on the minds of investors today, and that this issue is likely to remain the preeminent concern for some time to come. After a decade of negligible inflation, 2022 has seen prices increase across developed markets at paces not seen for 40 years, and investors are legitimately worried about how this will affect the value of their savings and the future cash flows they will depend upon.

Based on the trends we can observe in today's markets and our forecasts for the immediate future, the Shojin view can be summarised as follows:

1. **Contrary to the past decade where other factors took prominence, inflation currently represents the most significant threat to both fixed income investments as well as equities.**

2. **This situation is likely to persist for 12-18 months before stabilising again and will almost certainly necessitate further rate rises from central banks to bring inflation down to the 2% target set by the Bank of England.**

3. **The combination of sustained and high inflationary pressure with rate rises and generally tighter monetary policy constitutes a radically different macroeconomic environment, and investment approaches accordingly need to be rethought.**

4. **Alternative investments will have a growing role to play in this new context, and within this overall category it is real estate that offers one of the best possibilities to outrun inflation.**

5. **Lastly, the unique combination of benefits attributable to real estate as an asset class (diversification, income yielding, capital appreciation, etc.) will shine ever more brightly in the immediate inflationary context.**

This report will substantiate our view as summarised above, and present some of the arguments and evidence that have led us to this perspective.

2009 – 2020: THE DECADE OF UNSTOPPABLE INDEXES

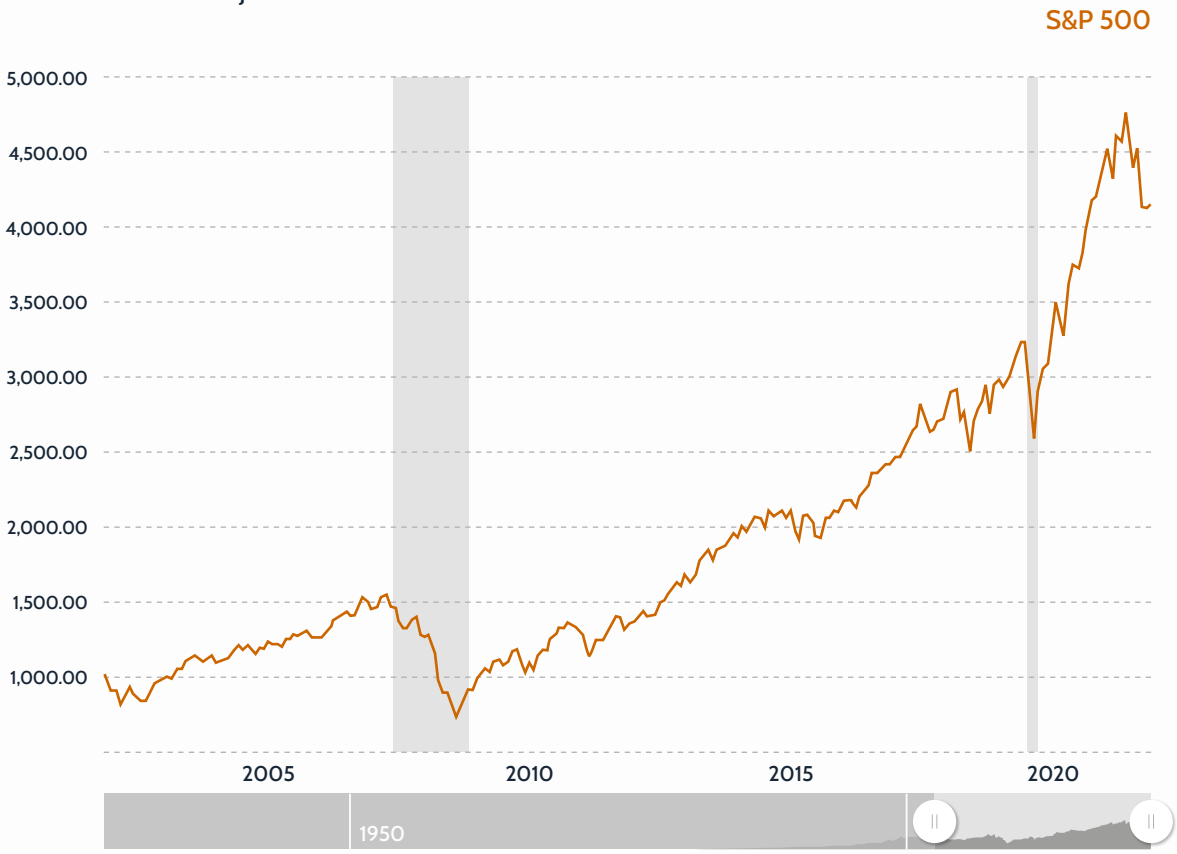
With some variation, the major developed economies all responded to the Global Financial Crisis of 2008 with stimulus packages on scales not previously seen, or even considered possible. Whilst different governments emphasized different combinations of fiscal and monetary stimulus measures, the overall effect was to flood the global financial system with liquidity in the hope that recessions didn't tip into depressions.

In the UK, monetary policy was the preferred tool to reflate the economy after the 2008 crash, and the Bank of England simultaneously lowered interest rates to historic lows and began a program of bond buying known as quantitative easing in order to inject cash into the economy. Whilst such policies were effective in staving off the threat of depression, an unintended consequence that can be identified with hindsight is that the ultra-loose monetary conditions ushered in created the perfect conditions for equity markets to roar ahead as never before.

Whilst not in itself a bad thing, this has left many developed economy stock markets in vulnerable positions now that the prevailing monetary conditions are changing and rates are moving in the other direction. This had major ramifications for saving and investing and created at the time a so-called 'new normal' to which investors had to adjust.

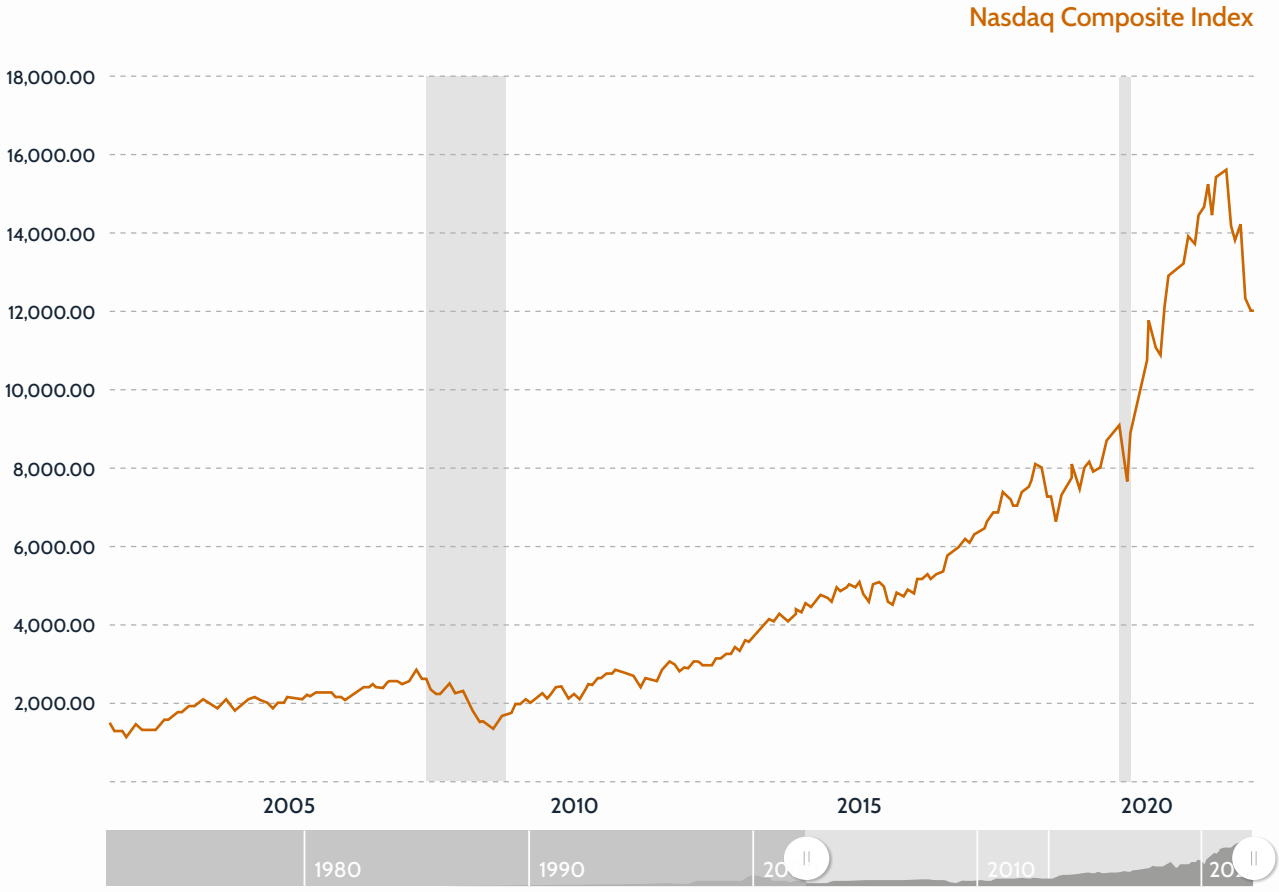
During the decade that followed the Global Financial Crisis, all an investor needed to do was to buy into any major stock market index fund or ETF and simply watch the value of the index ride to ever greater peaks on the back of seemingly endless money creation from central banks. Worryingly, these astonishing gains in major equity market indexes came against the backdrop of relatively weak economic growth, and we will return to this theme later.

Although this pattern was present around the world, nowhere was it more pronounced than in the world's largest and most liquid stock markets in the US. As can be seen below in charts sourced from MacroTrends, the S&P 500 index gained a staggering 525% from March, 2009 to December, 2021.



Source: MacroTrends

Meanwhile, these gains look paltry compared to the tech-heavy Nasdaq Composite index seen below which gained an eye-watering 1,362% over the same period. Throughout most of the period, it was tech stocks led by the FAANGs that accounted for a very large slice of the gains displayed in both indexes. Cheap money today gave investors every reason to take a gamble on tech companies that may generate substantial profits tomorrow.



Source: MacroTrends

IN SUMMARY

Those lucky enough to 'buy the dip' after the crash of 2008 saw extraordinary gains simply by holding low-fee, index-tracking funds. This was accordingly a tough decade for hedge funds and other proponents of active management, who struggled to make the case that their stock picking approach could keep up.

However, our view here at Shojin is that this chapter is now over, and investors must fundamentally rethink the approach they take to grow their savings over time. With central banks currently only now in the first stages of withdrawing the extraordinary monetary stimulus that allowed the public markets to balloon so dramatically (and potentially unsustainably) in value, investors who expect the 2020s to look like the previous decade are setting themselves up for disappointment.

INFLATION AND HIGHER INTEREST RATES ARE HERE TO STAY

The above summary of the investment climate of the past decade is needed to set in context the situation investors face today. With inflation approaching double-digit levels around the world and all major central banks starting to normalise interest rates by raising them from the ultra-low levels they have sat at for the past ten years, the possibility of simply buying an index and expecting record-breaking returns is now over.

This is because with tighter monetary policy in place there simply won't be the cheap – or the for the past decade, almost free – money available to continually inflate equity prices. Simultaneously, the resurgence of inflation puts pressure on the household spending that ultimately drives economic growth in the UK and other developed markets.

Lower consumer spending inevitably means lower growth, and whilst inflation is primarily reported as a hit for consumers, business margins will be eaten into as well, forcing firms to absorb a double-hit of lower consumer spending at a time when their margins are coming under pressure.

Into this negative mix, which is already starting to bear the hallmarks of what economists term stagflation – low growth with high inflation – central banks are compelled to introduce higher interest rates given their mandate to achieve price stability by controlling inflation.

Researchers at LSE have recently argued that inflation is here to stay for a while, and it is hard to disagree. Our view here at Shojin is that the inflation currently being experienced is not merely 'transitory', as central bankers initially argued, but likely to be a slightly more prolonged macroeconomic phenomenon due to the ongoing effect of Covid lockdowns in China, the war in Ukraine, and spiralling energy prices. This means rates will have to rise further than they have so far, and the shock this represents for an economic system hooked on low rates for over a decade cannot be overstated. That being said, interest rates have been artificially low for a long time and a return to normalisation is required, albeit we anticipate a bit of a rocky path in doing so.

> The possibility of simply buying an index and expecting record-breaking returns is now over

Although higher interest rates could lead to fewer successful mortgage applications, and so could dampen demand in the housing market, as will be explained further below there are numerous strong arguments as to why real estate as an asset class is set to outperform equities over the coming decade.

Average UK house prices have risen by just over 61% in the last ten years

ALTERNATIVES GOING MAINSTREAM

Alternative investments are any asset other than stocks, bonds, or mutual funds. Prominent within this category are assets like real estate, infrastructure, private equity, hedge funds, commodities, and even rare art or other collectibles. These investments have in common that they are typically less liquid than traditional investments and often contain the potential for significantly higher returns in comparison to stocks and bonds. This enhanced potential return does, however, come with additional risk in comparison to the safety of index-tracking funds or other relatively low-risk traditional investment vehicles.

> The passive approach may no longer suffice in the new macroeconomic conditions

It has been clear for some time that the role alternatives are playing in the investment world has been expanding at an unprecedented pace. Research from Preqin forecasts that growth in alternative assets under management is so fast that it will reach $23.21tn in 2026, and this may even be an understatement given the expanding appetite to diversify beyond stocks and bonds.

The fundamental driver of this expansion has been the need for investors, both institutional and individual, to diversify their portfolios to achieve two objectives.

1. **Firstly, alternatives can provide a hedge against the risk of public markets declining – an extremely likely possibility given the weak underlying economic data and the fact that rates are now moving up.**

2. **Secondly, the need to aim for market-beating returns providing superior capital appreciation in comparison to that offered by the passive approach that may no longer suffice in the new macroeconomic conditions.**

Comparisons are regularly being drawn between the situation today and that faced by the Western economies in the 1970s. The oil price hikes orchestrated by OPEC as well as the decline of British manufacturing, energy shortages, and increasingly frequent strike action were then credited with ushering in the first instance of stagflation.

Considered to be extremely unlikely if not quite theoretically impossible by economists at the time, stagflation scared the common imagination to such an extent that it prompted politicians like Thatcher and Reagan to take extreme measures to tame price inflation and then restart growth in the 1980s.

For stock markets, the 1970s was something of a lost decade without significant gains and regular reversals. Even if comparisons to the situation today are not fully accurate, it isn't hard to see why alternative investments are so rapidly gaining in popularity. In a context where the gains from traditional equity markets are almost certain to be much more subdued over the coming years, alternative assets provide a much-needed source of growth potential.

REAL ESTATE VERSUS INFLATION

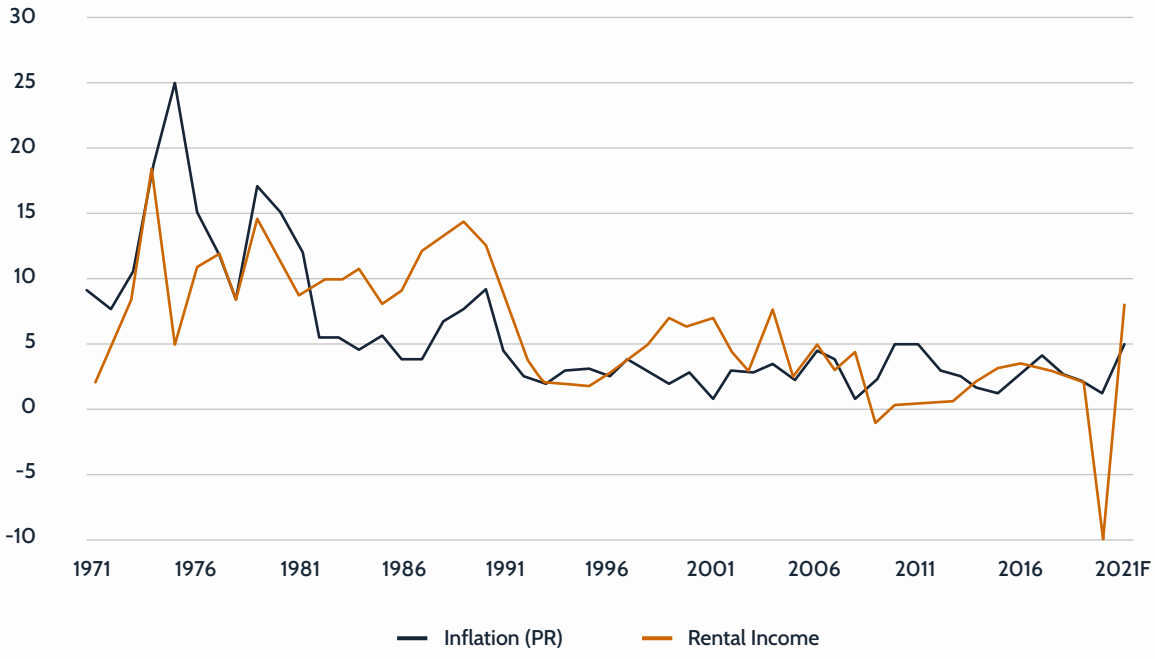
Real estate is in many ways the perfect asset to hold in times of high inflation. This is due to three factors unique to property which give it tremendous power to fight against inflation eroding the value of your savings.

1. REAL ESTATE IS AN INCOME YIELDING ASSET

First and foremost, real estate holdings generate income for their owners which usually rises ahead of or at least in line with inflation. As can be seen in the chart below sourced from Schroders, there tends to be a direct relationship between inflation and rents in the UK market, meaning high inflation is usually offset by higher rental income for property owners.

Although the corelation between the two is only around 0.6, there is enough evidence to suggest rents do provide a very decent hedge against rising inflation.

UK Inflation and Rental Income

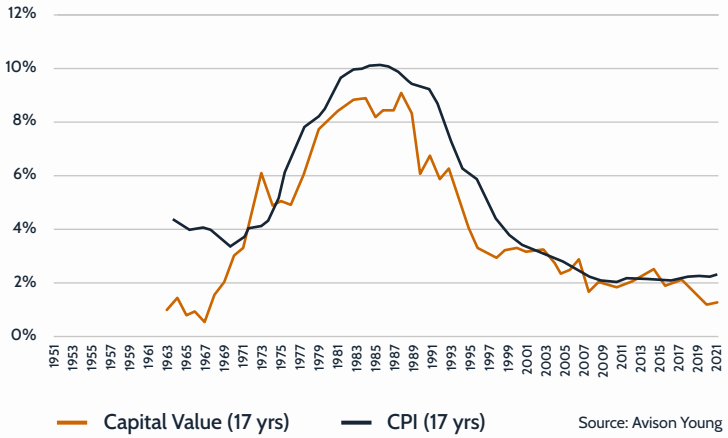


Source: MSCI, ONS, Schroders, October 2021.

2. STRONG CAPITAL APPRECIATION POTENTIAL

As well as yielding a steady income on a month-by-month basis, over a longer-term time frame real estate assets also present fantastic opportunities for investors to enjoy capital appreciation. This is because the essential nature of housing combined with the persistent mismatch between supply and demand in the UK housing market makes prices subject to strong upwards pressure over time.

Rolling 17 years: Correlation 0.92



Summarising research conducted by Avison Young, UK real estate capital values do protect against inflation over the longer term, although their performance in this regard is slightly weaker over shorter periods of one or two years alone.

As can be seen in the graph to the left, the relationship between real estate capital values and inflation has a correlation of 0.92 over a 17-year period. This is a very good level of inflation protection and stands considerably higher than that achieved by equity indices. For example, the FTSE all-share correlated with inflation over the same periods was much lower at just 0.59.

3. FALLING REAL VALUE OF DEBT

Lastly, inflation serves to lower the purchasing power of money, and therefore has the effect of reducing the real value of debt. This feature of inflation is especially relevant to real estate given the extremely high likelihood that property purchases of all types and sizes are financed by the owner taking on debt at an interest rate usually fixed for several years. This can be thought of as an indirect 'reward' for those investors able and willing to use some degree of leverage to obtain real estate assets that both rise in value and yield an inflation-proof income enabling them to pay down their debt with relative ease.

Shojin has a truly unique value proposition

PROPERTY OR PENSION?

Given the conclusion seen above that holding real estate assets is likely to beat inflation over a time frame of several decades, it is natural to consider how property compares to saving into a pension. Pensions are similar investment products to the extent that they also promise long-term capital appreciation as well as a steady income after a certain age.

However, whilst paying into a pension is inevitably a sensible option for all working-age investors, we believe there are compelling reasons real estate deserves to take precedent over (but certainly not instead of) pension provision.

1. STRONG TREND OF CAPITAL APPRECIATION

Average UK house prices have risen by just over 61% in the last ten years, and this compares very favourably to a 32.7% increase in the UK stock market over the same period. Whilst past performance isn't always a strong indicator of the future trajectory, this is comparison is certainly very favourable for real estate. Whilst macroeconomic forecasts should always be taken as rough estimates at best, a future scenario where UK house prices fall for a sustained period of time seems unlikely to the extent that it can effectively be ruled out as a situation worth considering.

2. ACCESS TO CASH

Secondly, given that a pension is only accessible from a certain fixed date, property investments offer significantly more flexibility to access cash in the short term. Importantly, this access to cash in the decades before your retirement date can be achieved without sacrificing the long-term capital appreciation gains both pensions and property can offer.

3. THE RISKS OF DEFINED CONTRIBUTION SCHEMES

Thirdly, a majority of UK pension schemes today are Defined Contribution schemes. This means that the amount you pay in is fixed, but the sum you will get back is variable, primarily depending on the performance of the stock market. This means that those savers unlucky enough to reach retirement age in a period of recession will see their retirement pot deflate rapidly and irreversibly. As a stable and reliable store of value, real estate assets seldom face the same risk.

4. PRACTICALITIES

Lastly, in terms of the practicalities of investing in a pension or directly investing in property, pension investing wins hands down. Investing into a pension is vastly more straightforward than running a portfolio of properties and all the admin and multitasking that comes along with this.

However, this is where real estate investment platforms such as Shojin have a truly unique value proposition – by making investing in property as clear and simple as investing in the stock market has become, Shojin can unlock the superior returns and yields to be had from property as an asset class, without the practical difficulties that result from being a landlord.

SHOJIN UNLOCKS HIGHLY PROFITABLE REAL ESTATE INVESTMENT OPPORTUNITIES

Our view is that real estate assets represent the best way for ordinary investors to diversify their portfolios in the current high inflationary context. Whilst the virtues of real estate were perennial, in the macroeconomic environment of 2022 these strengths stand out all the more sharply. Accordingly, we believe real estate can play an important role in the portfolio of any long-term investors who want to secure some level of predictability in their investment's appreciation over time.

As a specialised investment platform bringing lucrative real estate investment opportunities to as wide an audience as possible, Shojin is extremely well-positioned to assist investors seeking to diversify their portfolios. We have a track record of bringing property investments to the market which have achieved superior returns, and we are ready to help you on your investment journey towards building an inflation-proof portfolio today.

ABOUT SHOJIN

Shojin is an FCA-regulated online real estate investment platform that lowers the barriers to entry for individuals across the globe looking to access institutional-grade real estate investment opportunities in the UK.

Launched in 2017, the platform aims to make investing into mid-market property developments simple and attainable through a co-investment model. Meanwhile, Shojin is providing developers with a consistent and trusted source of junior finance, primarily focusing on residential, PRS (private rented sector), senior, and student accommodation projects.

Typically, such institutional-grade property deals are only accessible to the top 1% of the world's population. Shojin's platform enables global investors to access this market from as little as £5,000.

Shojin ensures a perfect alignment of interests with its investors by co-investing its own capital into every project and sharing profits, rather than take large upfront and management fees.

Globally, Shojin has offices in Hong Kong, East Africa, and joint venture partnerships with real estate investment platforms in the UAE, India, and Israel with others launching this year.

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