2021 Economic and Real Estate Outlook

2020 was an unprecedented year for investors. Financial markets saw unparalleled levels of risk, volatility and uncertainty, reinforcing again the importance of proper diversification in portfolio construction with investments not correlated to the broader markets. Alternative investments such as institutional real estate demonstrated the benefits of diversification, including generating income and lower volatility to the broader markets.

Below we present the Bluerock 2021 economic outlook.

PANDEMIC OUTLOOK

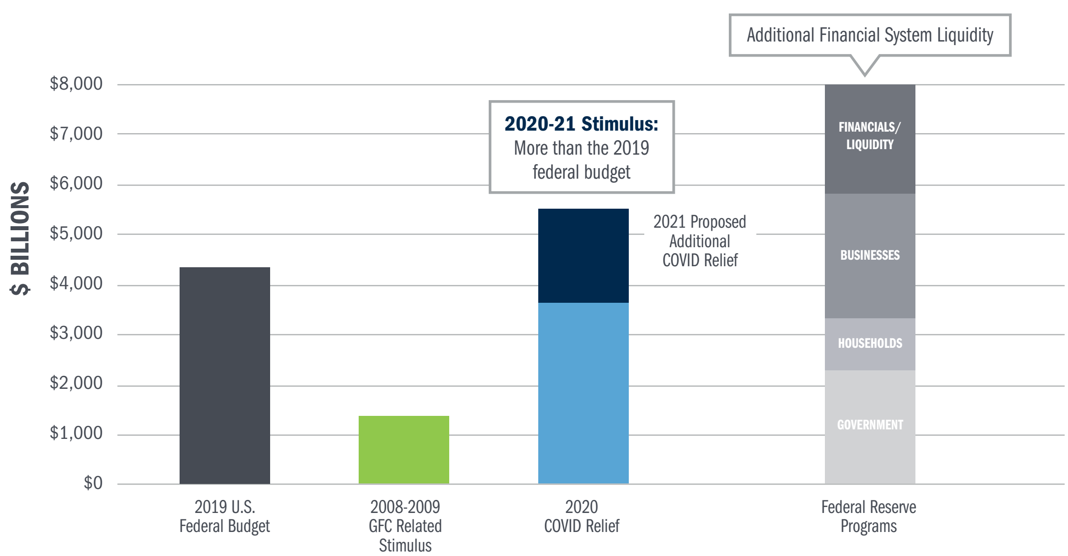
The U.S. and the world will see solid and accelerating economic recovery driven by the widespread availability and efficacy of COVID-19 vaccinations

The U.S. economy bounced off its 2020 lows by the end of the year and projections call for GDP to recover to pre-COVID levels by the end of 2021.[1] By the middle of 2021, we expect that vaccine supply will closely meet demand which should lead to widespread lifting of restrictions and a rapid rise in travel and leisure services as well as drive significant growth in GDP for the year.

ECONOMIC POLICY OUTLOOK

Extraordinary monetary and fiscal stimulus will support and strengthen the U.S. recovery, further reducing the national unemployment rate

Unprecedented economic decline prompted a forceful stimulus from the federal government and Federal Reserve in 2020 as shown in the graph below. The unemployment rate has already been cut in half from its April peak,[2] and with the additional fiscal stimulus and continued monetary accommodation the economy should be sufficiently supported to generate additional jobs, lowering the rate even further.



Sources: Congressional Budget Office; White House; Congressional estimates

HOUSEHOLD WEALTH OUTLOOK

The U.S. economy will exhibit tremendous resiliency as several household economic indicators are signaling surprising strength

While the economic rebound has no doubt been uneven, broad measures indicate surprising strength. Household net worth and total retail sales have both reached new record highs by the end of 2020.[1] Although policy intervention has certainly helped, the 2020 recession was very different from the Great Financial Crisis and other financial recessions which lasted much longer and experienced slower recoveries.

POLITICAL ENVIRONMENT OUTLOOK

A narrow Democratic majority may moderate extreme structural policy overhauls, creating further certainty in the recovery of the economy and financial markets

Markets generally react negatively to political uncertainty and potential policy changes which could impact corporate earnings and economic growth. However, despite the change in the Presidency, a 50/50 Senate split and narrow Democratic majority in the House could moderate more extreme changes in tax and other economic policies. Despite proposed corporate tax increases which could drive lower earnings and negatively impact equity market valuations, we do not envision a political climate that will fundamentally derail the economic recovery.

INTEREST RATE OUTLOOK

Near zero and negative interest rates in the U.S. and the developed world are the most important financial market developments

Interest rates have essentially been declining for 40 years in the developed world. The yield on the 10-year U.S. Treasury note ended 2020 at 0.92%, a decline of over half from its 1.89% yield at the start of the year. The rest of the developed world has experienced even more extreme declines with over $17 trillion of sovereign debt carrying negative yields.[3] The Federal Reserve has signaled their plan to keep rates low for an extended period of time, challenging fixed income investors' search for yield, and impairing bonds' diversification benefits. The global search for yield and portfolio diversifiers will be a defining theme of the 2020 decade, and could drive significant additional demand for alternatives such as institutional real estate which can provide both yield and portfolio diversification.

	Benchmark policy rate	1 yr	5 yr	10 yr	20 yr	30 yr
Germany	(- 0.50%)			(- 0.57%)		
Switzerland	(- 0.75%)			(- 0.57%)		
Netherlands	(- 0.50%)			(- 0.49%)		
Denmark	(- 0.60%)			(- 0.47%)		
Austria	(- 0.50%)			(- 0.43%)		
Finland	(- 0.50%)			(- 0.41%)		
Belgium	(- 0.50%)			(- 0.38%)		

	Benchmark policy rate	1 yr	5 yr	10 yr	20 yr	30 yr
France	(- 0.50%)			(- 0.33%)		
Ireland	(- 0.50%)			(- 0.27%)		
Japan	(- 0.10%)			0.02%		
Spain	(- 0.50%)			0.08%		
UK	0.10%			0.30%		
Italy	(- 0.50%)			0.62%		
US	0.25%			0.85%		

Negative Yields Positive Yields

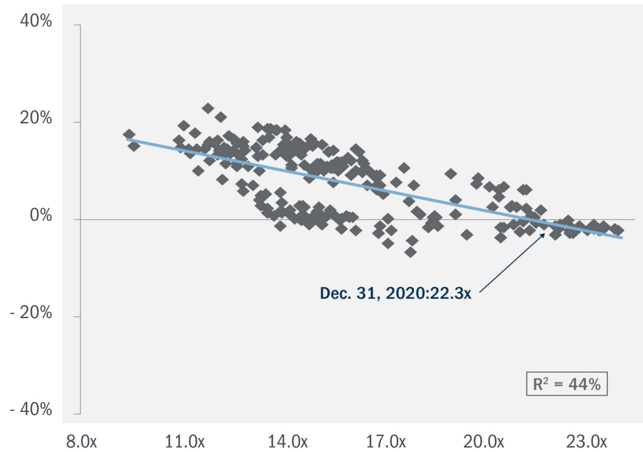
EQUITY MARKET OUTLOOK

High stock market valuations have historically indicated underperformance over the next 5 years, in addition to increasing potential risks for large drawdowns and volatility

Equity market drawdowns have averaged 14% every year since 1980. Current price/earnings ratios are well above historical norms which has historically indicated below average forward returns.

Forward P/E and Subsequent 5-Year Annualized Returns

S&P 500 Total Return Index



Source: JP Morgan Guide to the Markets, Q1 2021.

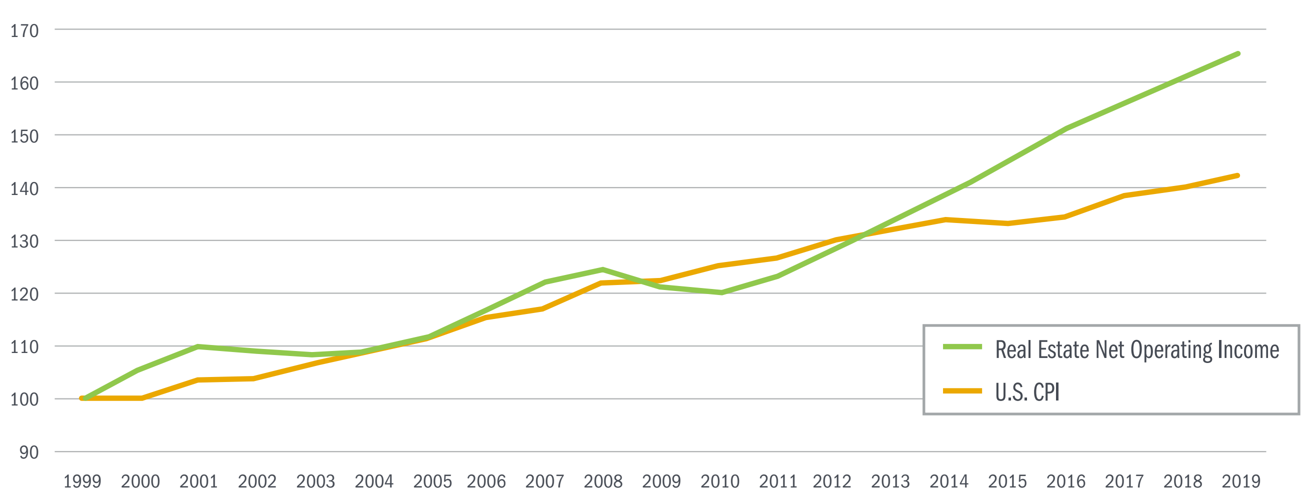
R^2 represents the percent of total variation in total returns that can be explained by forward P/E ratios.

INFLATION OUTLOOK

Extraordinary fiscal and monetary stimulus may spur inflation which should boost hard asset values such as real estate

Real estate net operating income increases have historically exceeded inflation making it an effective hedge against potential future inflation.

Real Estate Income and Inflation (Indexed to 100)



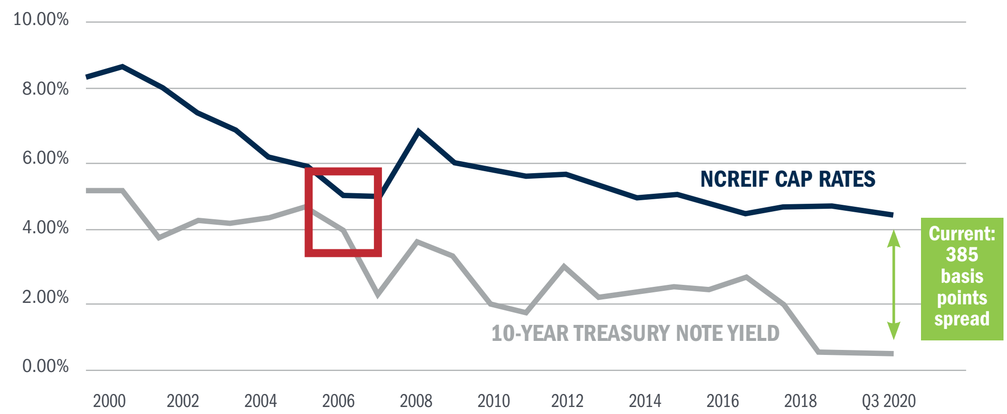
Source: Green Street Advisors, Bureau of Labor Statistics. Net Operating Income (NOI) growth represents the average NOI growth by year across the apartment, industrial, mall, office and retail strip center sectors. The Consumer Price Index (CPI) measures changes in the prices paid by urban consumers for a representative basket of goods and services. Analysis as of Q4 2019.

INSTITUTIONAL REAL ESTATE OUTLOOK

Yield spreads for institutional real estate are historically high which should propel values higher

We believe the confluence of low interest rates and relatively high capitalization rates (cap rates) have created a historic event signaling an opportune time to be invested in institutional private real estate. When spreads between the 10-Year Treasury note yield and Real Estate yields exceed 375 basis points, it has historically indicated that private real estate valuations are attractive on a relative basis and are poised to deliver strong returns - see chart at bottom. Institutional real estate cap rate spreads are nearly 400 basis points, well above their long term average as of Q3 2020, indicating potentially higher future institutional real estate returns.

Historical Cap Rates and 10-Year U.S. Treasury Note Yields | 2000 - Q3 2020



Historically, periods of cap rate spreads higher than 375 basis points have resulted in above average forward returns, including 15% and 13% annually over the next three years starting in Q2 2003 and Q3 2010 - see chart below. We are bullish on the asset class for 2021, but believe active management will be critical as there are likely to be large disparities in sector performance.

Historical Cap Rates Spreads | 2000 - Q3 2020

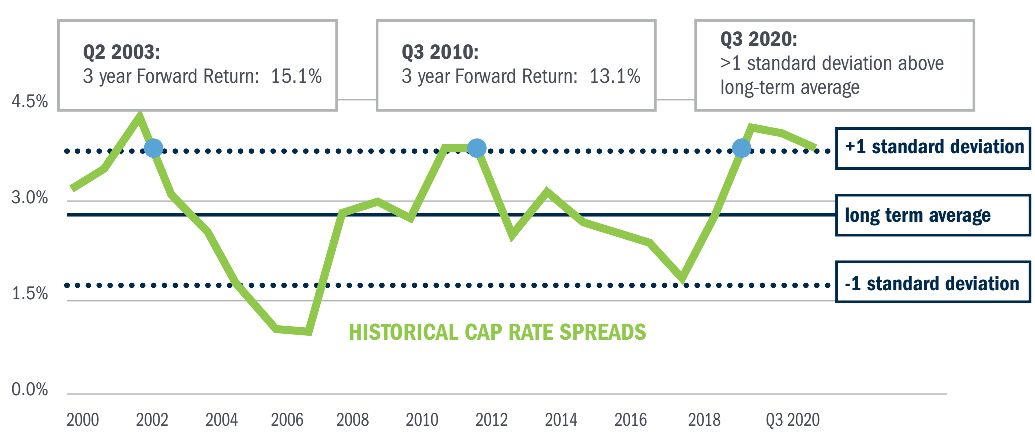


Chart sources: NCREIF property average valuation cap rates and Federal Reserves economic data for the 10 year U.S. Treasury Bond Yields.

PROPERTY SECTOR AND MARKET OUTLOOK

Real estate sector performance divergence may be the defining and lasting characteristic of the 2020 recession as industrial, apartments, and life science/medical office sectors have fundamental advantages over retail and traditional office space in the near term

We see the real estate impacts of COVID as accelerating trends that were already in process. We envision 2021 performance to significantly diverge as sectors with strong fundamental drivers will thrive and other sectors may be challenged. The growth of e-commerce and associated need for industrial space should continue to propel industrial valuations higher. We also see opportunity in the apartment sector as vacancy rates remain low and rents are likely to increase on a broad basis, most notably in high growth Sunbelt markets. The life science sector is also one of the most attractive specialty sectors driven by biotechnology innovation. Broadly, we are theme-based investors and we summarize key themes and our favored subsectors below.

Sector	Secular Tailwinds	Subsectors	Sector	Secular Tailwinds	Subsectors
INDUSTRIAL	E-Commerce	Last-Mile Warehouse Cold Storage	SPECIALTY	Technology and Medical Advancements	Medical Office Life Science
RESIDENTIAL	Demographics	Single Family Rentals Affordable Class A Apartments	REAL ESTATE DEBT	Capital Protection	Multifamily Loans First Mortgages

We wish you a happy and prosperous new year and we hope you look to Bluerock as you navigate today's complex world of financial and institutional real estate markets.

Footnotes: 1) Clarion House View, October 2020, Moody's forecast 2) Bureau of Labor Statistics 3) Bloomberg, November 2020

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1345 Avenue of the Americas | 32nd Floor | New York, NY 10105
Bluerock.com