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Buffett's Investment in STORE Capital Benefits Net Lease Sector

On June 26, STORE Capital Corporation (NYSE: STOR) announced that Berkshire Hathaway acquired a 9.8% ownership interest in the company through a private placement investment of 18.6 million shares at a price of $20.25 per share or $377 million, representing 9.8% of shares outstanding. The investment by Warren Buffett, through Berkshire Hathaway, was viewed not only as a vote of confidence for STORE Capital specifically, but also as a vote of confidence for the net lease sector as a whole. Berkshire Hathaway has historically not been a major investor in the REIT sector. Thus, the large investment in a net lease REIT is a noteworthy event. Furthermore, Buffett's investment was viewed favorably by operators in the net lease sector as recent concerns about the sector, primarily related to rising interest rates, are generally misguided. As discussed in more detail below, the net lease sector has been a top performer when compared to both the REIT sector as a whole and major equity indices and the performance of the net lease sector has not historically been highly correlated to interest rates.

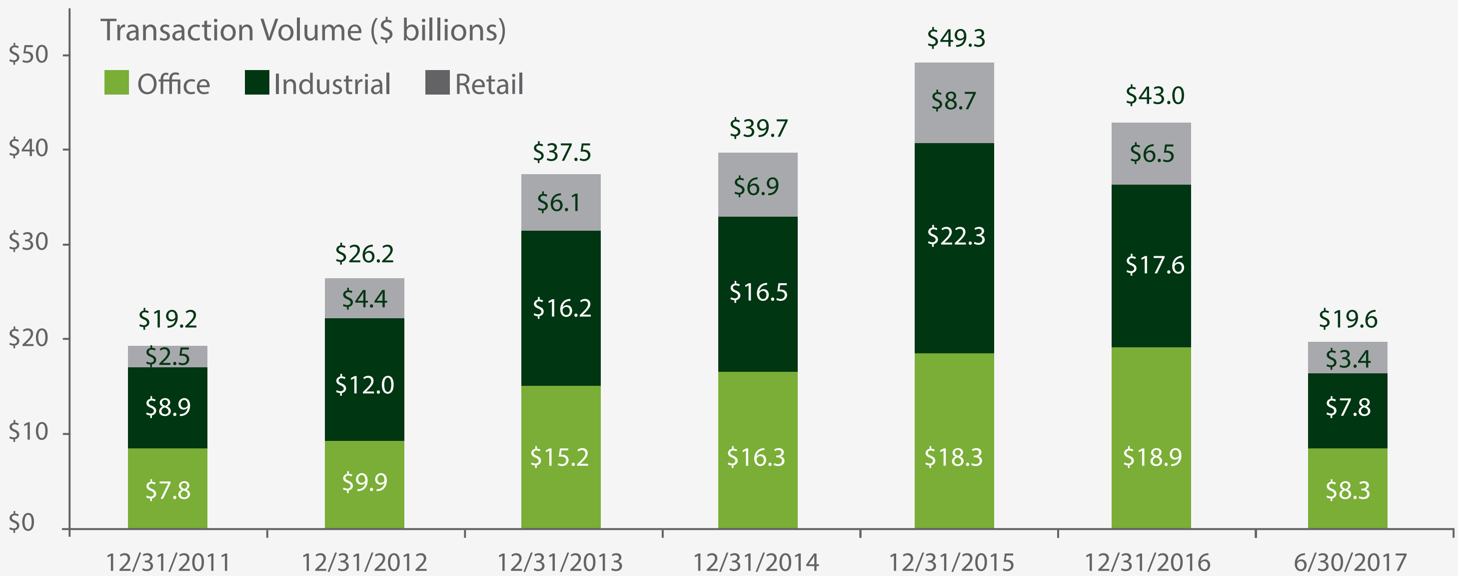
Performance in the net lease sector has historically been highly attractive as evidenced by Bank of America Merrill Lynch's analysis of historical net lease REIT performance vs. the MSCI US REIT Index (RMZ) and the S&P 500. Based on data ending December 30, 2016, net lease REITs, excluding VEREIT, have outperformed both the RMZ and the S&P 500 over all periods analyzed (10 years, 5 years, 3 years and 1 year). Over the last 10 years in particular, net lease REITs, excluding VEREIT, outperformed the RMZ by 101 basis points and the S&P 500 by 67 basis points on a total return basis. Nonetheless, some investors have become skeptical about the sector, primarily due to fears related to rising interest rates. However, historical studies have shown that the net lease sector is not highly correlated to changes in interest rates.

For example, Bank of America Merrill Lynch recently completed a correlation study on publicly traded net lease REITs. The analysis showed that despite being called bond proxies, net lease REITs have very low correlations to changes in bond yields. In the study, the correlation between changes in net lease REIT yields and treasury yields was less than 0.10 and the correlation between net lease REIT yields and yields for the BAA 10-year corporate bond index was only 0.18. Bank of America Merrill Lynch also looked at the correlation between bond yields and net lease REIT's share prices. In like manner, the correlations were relatively low across all the key bond yields analyzed. The highest correlation was between the BAA 10-year corporate bond index and net lease REIT's share prices, which was only (0.22). The correlation is negative because a decline in a bond's yield generally corresponds with an increase in a net lease REIT's share price. In total, this study provides substantial evidence that the performance of the net lease sector is not highly correlated to movements in interest rates and bond yields.

Rather than being driven by changes in interest rates, the performance of the net lease sector is driven by a confluence of several factors, which primarily include U.S. economic trends, market fundamentals, supply and demand for net leased real estate, and the amount of capital investing in the asset class. Looking forward, the net lease sector is poised to continue to deliver strong results for investors, even in a potential slowly rising interest rate environment as U.S. economic outlook is positive and net lease market fundamentals continue to improve, especially for net leased industrial and office assets. Demand for industrial assets continues to show substantial growth due to the rising demand for warehouse and distribution facilities that can serve a growing number of e-commerce users and demand for office assets will continue to benefit from expected growth in the U.S. economy. Additionally, the amount of capital entering the sector is expected to continue to increase from both foreign and domestic investors alike, which will provide an increased level of liquidity and stability in the net lease sector that has not been witnessed in previous real estate cycles. This increased liquidity will make the sector an even safer investment class as investors will continue to benefit from the stable cash flow provided by rental income, but prices and cap rates will remain more stable than in previous cycles. In total, the confluence of these positive factors creates an investment environment that is highly favorable to investors seeking both current income and strong preservation of capital and Warren Buffett's recent investment in the sector affirms the asset class should be strongly considered as part of any well diversified investment portfolio.

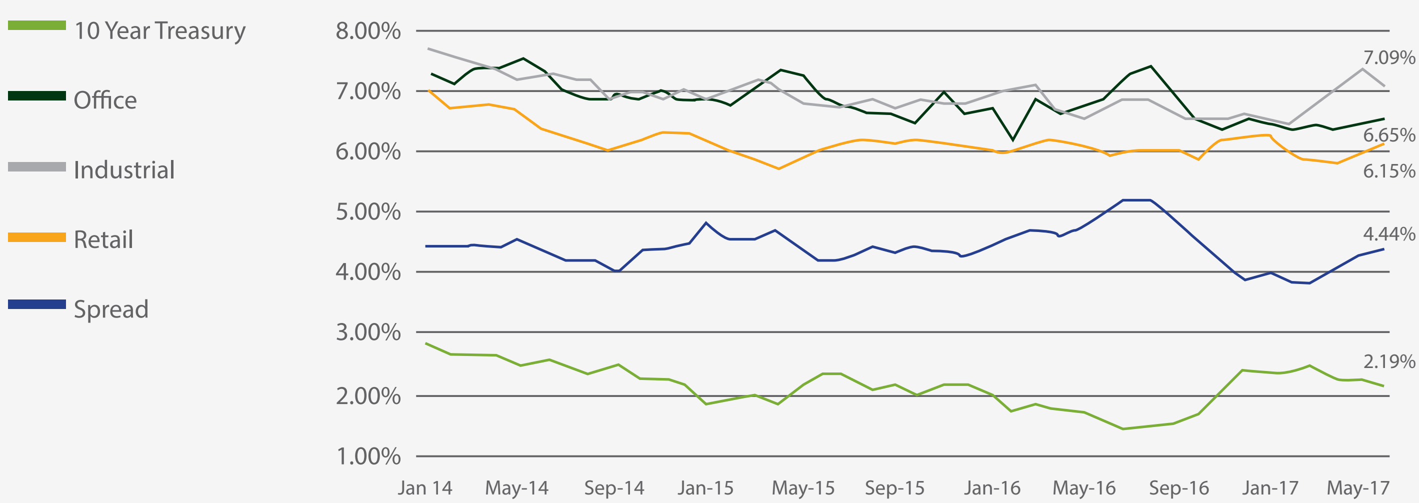
Net Lease Market Update

Annual Single-Tenant Net Lease Sales ($ Billions)



Source: Data from Real Capital Analytics as of 7/1/2017

Single Tenant Cap Rates vs. 10-YR Treasury Yield



Source: Data from Real Capital Analytics as of 7/1/2017

For more information regarding this newsletter or other related net lease matters, please contact Wes Walker or Jason Ridgway at:
8027 Forsyth Blvd, St. Louis, MO 63105 | p: 314.828.4200 f: 314.828.4220 | www.elmtreefunds.com

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