Will duETS markets become one-sided?

Summary

Down/Up Equity Trust Securities (duETS) were specifically designed to allow for market forces to drive securities prices. If demand for a particular security (e.g. Down or Up) is high, the price of that security will increase and the opposite security will decrease until the market reaches equilibrium.

Due to the paired nature of duETS, if the price of the Down (or Up) gets bid up, then the price of the Up (or Down) will become lower in the market. This reciprocal effect allows opportunistic investors to evaluate the low prices to determine if it represents a buying opportunity.

Just like in physical real estate, there will likely be times when the bid/ask spread for duETS is wide and there are low trading volumes. Low trading volume may be an indication of a wide difference of opinions on the future of the real estate markets. Some holders, firm in their conviction on the direction of the real estate markets, will be willing to hold onto their positions; much like real estate market participants choosing to ride out the financial crisis of 2008-2009.

duETS are designed for real estate

duETS are designed to be linked to a real estate index. Since real estate is a broad illiquid asset class, duETS cannot have a '40 Act ETF style creation basket. What would you hold as the underlying securities replicating the index? Because duETS are based on privately owned real estate (commercial property), they must have a cash create.

When the GIG Real Estate Trust receives cash through the Custodian, it will be invest that cash in 2 year Treasuries and in return will issue a corresponding number of Down Securities and Up Securities. At Index Valuation Date, the value of the securities, Down and Up, are tied to the change in the index level over the two-year Measurement Period. Between Index Valuation Dates (24 months), the prices of the Down Shares and Up Shares will fluctuate with market demand and sentiment; typical of any security listed on an exchange.

Market participants will base their investing strategies on where they expect the index level to be on the next Index Valuation Date. The last published index level will be a factor in their investment decisions, but not the only one.

Real Estate: Stale and Short Term Predictable Indexes

Since real estate is an illiquid asset class, private real estate indexes will typically have monthly or quarterly published index values. With the initial duETS, the securities will be linked to an index published once a quarter (NCREIF MVI). This means the last published index value is likely to include prices at least three months old in its calculation.

Based on the last published index value and the tide of economic events happening during a quarter, economists and other forecasters have become good at anticipating the following quarter's index value.

Tying Price to Last Published Index – One-Sided Market

Since the valuation of duETS Downs and Ups are tied to the index value at Index Valuation Date and market participants have definite opinions on where the index will be prior to the publishing of that last index value, the market will drive Down and Up prices towards those implied by the market consensus forecast of where the index will be on Index Valuation Date, not some index value published before Index Valuation Date.

If Down and Up prices were tied to the last published index value, there would be one-sided markets based on investors' forecasts of where the index would be on Index Valuation Date.

Down and Up Prices Set by Market Supply and Demand

The trading prices of Downs and Ups will be set by market supply and demand of the two securities. If there are many bids to buy one security over another (Downs vs Ups), the price of that security will increase until supply and demand equilibrate similar to any other equity. Likewise, the opposite security will decrease in price to reflect lack of demand until such time as the markets dictate what a fair value is for both.

Conclusion

Down and Up prices will move in response to market demand. This price movement will always be in the direction of market clearing. For this reason, GIG believes the markets will not become one-sided for either security that makes up duETS.