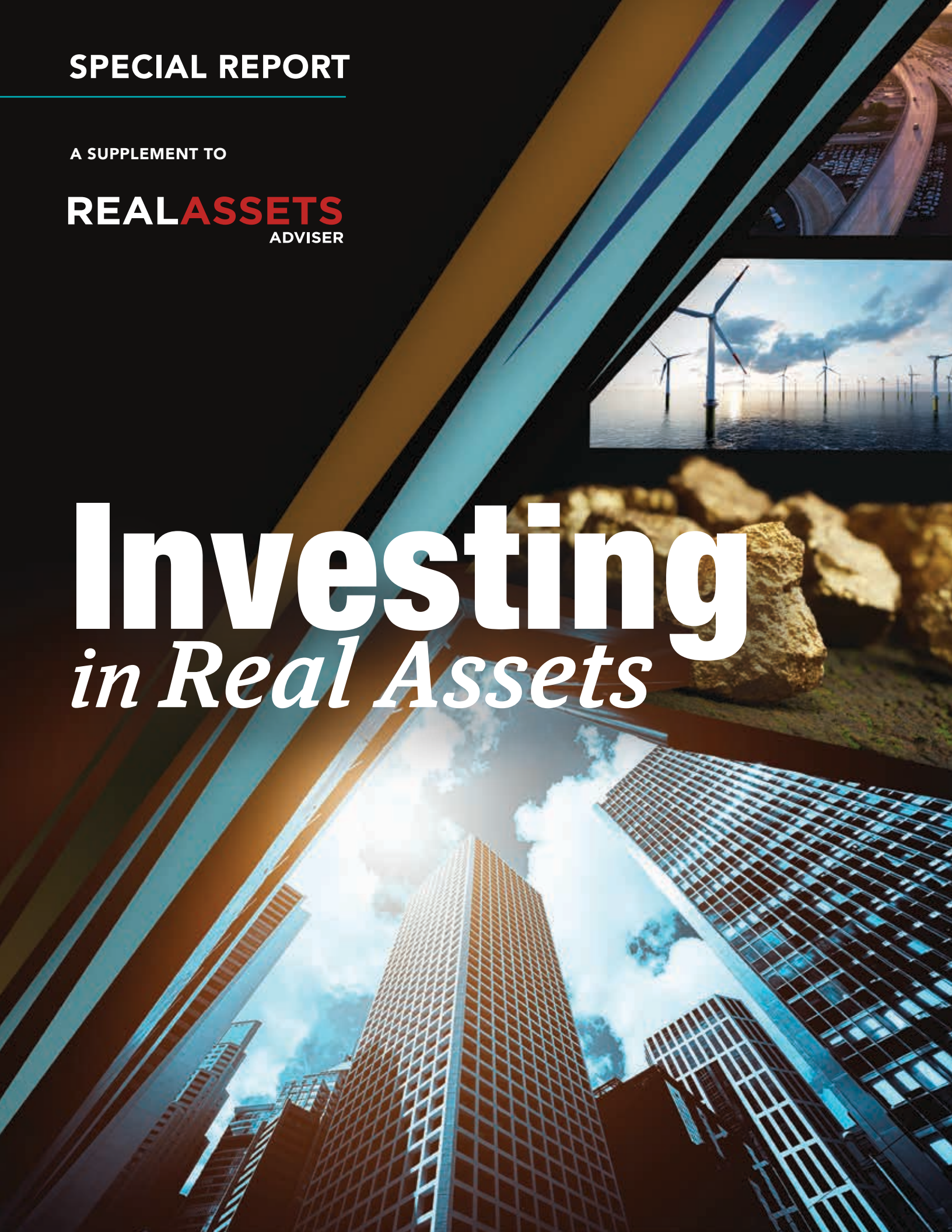


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Real Estate

A photograph of a city skyline at dusk, featuring several tall buildings with lit windows.

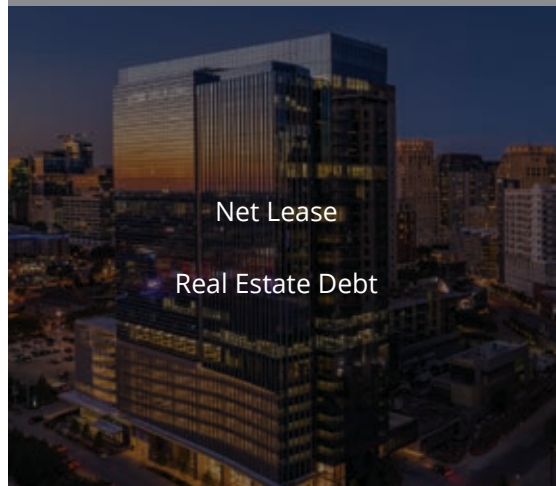
- Core
- Value-Add
- Opportunistic
- Ground-Up

Infrastructure

A photograph of solar panels installed on a rooftop, with a city skyline visible in the background.

- Digital
- Renewable Energy
- Water Management
- Waste Management

Credit

A photograph of a city skyline at dusk, featuring several tall buildings with lit windows.

- Net Lease
- Real Estate Debt

Investing in *Real Assets*

by Alexis Petrakis

A rising tide lifts all boats. Sounds perfectly acceptable when cash is flowing in, but what happens when the tide ebbs? In this era, as investors bemoan rising correlations among once disparate asset classes, most cannot afford another episode when all of their investments move down in lockstep. As such, one key question lingers: How should investors construct a portfolio in the current environment?

Many institutions and family office investors are embracing greater allocations to alternative investments and, specifically, real assets. Endowments and foundations are often credited with establishing the pioneering trend away from the traditional equities and fixed-income asset classes, and many are now proponents of having a significant allocation to real assets within their portfolios.

Simply put, real assets are tangible investments that we can touch and hold. The category is broad in its own right and includes real estate, infrastructure, precious metals, industrial commodities, soft agricultural commodities, farmland, and oil and natural gas, among many others.

The thesis for incorporating real assets into an investment allocation is largely built around the notion that they have a lower correlation to the stalwarts of most investment portfolios — equities and fixed-income. Many real assets also offer coveted inflation hedging, current income and even crisis-protection attributes.

Today's investors are faced with both inflationary and deflationary crosscurrents, and the unconventional (some may argue, extreme) monetary policies being pursued around the globe are further complicating matters for investors. This confusing macro environment is also fueling demand for real assets.

As always, there are risks associated with accessing these alternative investments, including liquidity issues, potentially higher fees and expenses, and challenges in choosing the right conduit with an appropriate risk profile — call that execution, or implementation, risk.

This special report offers some broad-level background on real assets, their merits and a few of the emerging trends surrounding this burgeoning asset class. We will also take a look into the specifics of the real estate, infrastructure, commodities, energy and “other” assets classes. Finally, we list some of the ways investors can access real assets, as well as some key considerations if they endeavor to incorporate them into their portfolios.

Real assets defined

Real assets are tangible assets. They have some intrinsic value due to their function or industrial usefulness or, as in the case of some precious metals, they represent a means to store value. A real asset is something you might be able to hold and touch, as opposed to a certificate indicating equity ownership of a company.

It is important to note any investment category as broad and diverse as real assets is bound to differ in scope depending on one's perspective. This category generally includes:

- **Real estate:** an enormously broad category on its own, it includes traded and nontraded REITs, listed property companies, and even direct property investments
- **Infrastructure:** typically, equity and debt vehicles backed by societal necessities, including toll roads, airports, ports, and many other subcategories
- **Land assets:** farmland, ranches and timber
- **The energy complex:** WTI crude oil, Brent crude oil, natural gas, heating oil, gasoline, coal and ethanol

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- **Alternative energy:** investments in solar, wind, biofuels and even nuclear power
- **Precious metals:** gold, silver, platinum, palladium and sometimes diamonds
- **Base metals:** industrial commodities such as copper, aluminum, iron ore, zinc, lead, steel and tin
- **Soft commodities:** a subset of agricultural assets that includes coffee, cocoa, sugar, rice, cotton and orange juice

This is not the complete list, nor is it the definitive categorization. Treasury Inflation Protected Securities (TIPS) are really a type of fixed-income asset, for example, but they are often considered real assets due to their inflation-indexed characteristics.

Technically, classic cars, artwork, stamps and coins, and other collectibles are also tangible real assets. And now there are environmental commodities in varying stages of development being traded on nascent carbon offset and climate exchanges. But when most investors and investment advisers speak of real assets, they are largely focused on the broadest and most liquid categories, as previously listed.

Why choose real assets?

Investors may consider a real assets allocation for any number of reasons, depending on their objectives and risk tolerances. In general, there are four characteristics that attract investors to real assets. These include:

Diversification and crisis protection: More than a decade after the global financial crisis, the memories were still fresh, and with the current global pandemic, the memories are in the forefront of people's minds. Plummeting asset valuations, liquidity issues and ongoing liability commitments were among the challenges that left scars on both high-net-worth and institutional investors. All this has motivated many investors to reconsider whether the traditional 60-40 portfolio mix (60 percent equities and 40 percent bonds) still makes sense. Is there a better asset-allocation model to follow, and are there better portfolio construction techniques available?

Vince Childers, CFA, a portfolio manager with Cohen & Steers, articulates perhaps the single largest concern facing investors today and why they are turning to real assets. In a February 2014 white paper titled *Exploring the Real Benefits of Real Assets*, he wrote: "We also believe that the frequency of periods when stocks and bonds simultaneously deliver below-average returns will correspondingly increase. After all, if bond returns fall below average, and stocks remain volatile, any sustained underperformance from equities could dramatically increase the odds of simultaneous stock and bond



underperformance. For investors concentrated in stocks and bonds, this likelihood presents heightened risks of lower overall portfolio returns, reduced ability to support spending from the portfolio, and possible failure to meet long-term investing goals."

Faced with this reality, investors have stepped up their quest for diversification and portfolio protection. Allocating to real assets — those that are less correlated to the often-abrupt gyrations of equities and fixed-income assets — may help lower volatility, smooth returns over time, and perhaps even deliver superior risk-adjusted returns over the long haul.

Hedging inflation: Real assets are widely considered an excellent hedge against inflation, though to varying degrees given the diversity of the asset category. "Several factors — such as supply/demand dynamics in underlying assets and investment time horizon — can influence the degree to which a real asset can provide inflation protection," explains Yogi Thambiah and Nicolò Foscari of Credit Suisse Asset Management in their white paper *Real Assets: Inflation Hedge Solution Under a Modified Risk Framework*.

Commodities with industrial uses, for example, may be able to effectively protect investment portfolios from the impact of inflation because these assets are valued based on products they help create, rather than currency.

Precious metals also are widely considered a store of value versus fiat currencies, though the debate here often skews to the emotional. Goldbug or not, precious metals have been a favored investment for inflationistas, but they also have performed well even in low-inflationary regimes.

Soft commodities are largely supported by global demographic demand trends, as well as potential supply constraints. And real estate is also viewed as an inflation hedge, though some argue that real estate can be skewed by external factors such as overleverage.

Total (enhanced) returns: Many investors turn to real assets for their potentially attractive long-term total return profiles, depending on the type of asset and vehicle. For example, some hedge funds or private equity-type investment vehicles with limited liquidity — such as those sometimes used to access farmland, timber or real estate investments — are marketed with



the intent to deliver returns in excess of the historical returns of stocks or bonds. The potential for enhanced returns often revolves around the long-term supply- and demand fundamentals of finite natural resources, coupled with the twin macro trends of global population growth and wealth creation in emerging markets.

Yield opportunity: The bull market in bonds is more than three decades old, and the ongoing yield compression illustrates the income challenges facing investors. Consider that U.S. Treasury bond yields dipped as low as 1.3 percent as of Sept. 2, and at year-end 2020, the yield on the 10-year U.S. Treasury bond was 1.01 percent. This challenge is not relegated solely to the United States. The trend of global monetary easing has driven government and corporate bond yields to historic lows.

As a result, traditional fixed-income instruments no longer provide adequate current income to high-net-worth investors, or to insurance companies and pension investors who need to match liabilities. Quite frankly, the world is starved for new sources of investment income.

Some types of real assets have the potential to step, however, in and help meet the demand for income-bearing investments. Real estate and infrastructure, in particular, are often structured with the dual purpose of providing higher levels of current income, along with the opportunity for capital appreciation. MLPs and REITs are also considered viable alternatives for adding diversified income streams to portfolios.

Factors shaping the real assets trend

Increasingly, institutional investors are gravitating to real assets for the powerful role that they can play in an overall portfolio. A report by J.P. Morgan Asset Management suggests a “tectonic shift in standard asset allocation” is under way, though the firm believes “it is relatively early in this structural shift.” Based on a database of more than 2,500 institutional investors — including public and corporate pensions, endowments and foundations in the United States — along with a survey of public statements from a sample of European and Asian pension plans and sovereign wealth funds, J.P. Morgan Asset Management’s Global Real Assets Group foresees that real assets will soon be a mainstream asset class, with

portfolio allocations rising from roughly 5 percent to 10 percent to as much as 25 percent in the next decade.

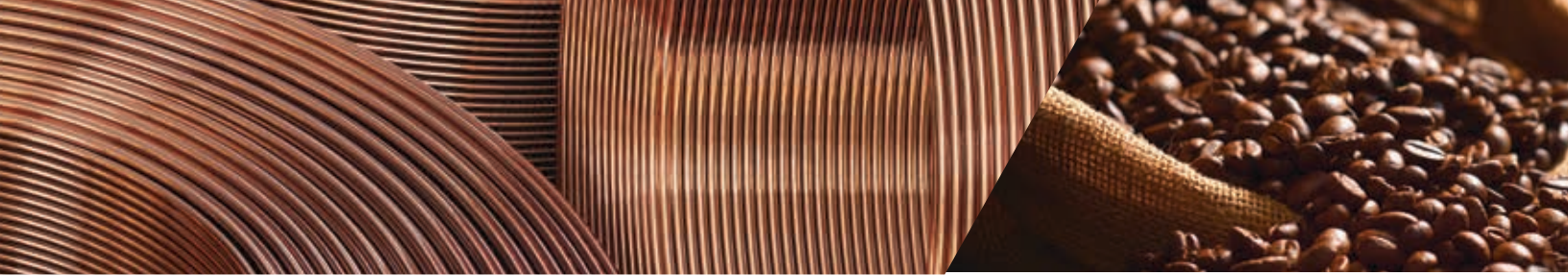
“Investors are at various stages of what we call the ‘Realization,’ a structural shift toward higher real asset allocations,” notes the report. “Those investors who recognize, embrace and act on this Realization in their portfolio allocations are likely to have better investment outcomes than those who do not.”

J.P. Morgan is not alone in seeing this trend toward a broader acceptance of real assets. Brookfield Asset Management sees a secular shift toward real assets that may “rival the historic transformation of institutional investment from fixed income to equity securities. We expect this trend to accelerate materially over the course of the next decade, with allocations to real assets reaching 20 percent to 30 percent of portfolios by 2030, with some institutional investors allocating upwards of 50 percent to the asset class.”

If these global asset managers who have their fingers on the pulse of institutional trends are correct, high-net-worth investors are likely to follow.

But what’s behind the growing demand for real assets? Several impressive macro trends are supporting the investment thesis and contributing to the growing optimism for this emerging mainstream asset class. Consider:

- In March 2021, McKinsey Global Institute published a report estimating the world needs to increase infrastructure investment to \$3.3 trillion per year through 2030 simply to meet current growth projections, of which emerging economies will represent 60 percent of the growing infrastructure investment need.
- Demographic trends are also constructive for real assets investing. World population is projected to grow from 6.1 billion in 2000 to 8.9 billion in 2050, according to the U.N. report *World Population to 2300*. Who will feed, clothe and house all these people? Who will power their energy needs? The gross numbers alone are compelling for many real assets, but the bullish case only becomes more persuasive when considering the compounding impact of the wealth creation happening in the burgeoning middle classes of China, India and other parts of the developing world.



- An aging population craves income. According to a report from the Pew Research Center, the number of people 65 and older is projected to triple by mid-century, from 531 million in 2010 to 1.5 billion in 2050. In the United States, the population of seniors is expected to more than double, from 41 million to 86 million. This graying of the population is likely to boost demand for income-producing investments. Many investments in real assets — including infrastructure, real estate and renewable-energy investments, among others — are being structured to meet the dearth of income-producing investments in the current low-yield environment.
- Population growth and urbanization trends in China and other developing nations are fueling housing demand globally.
- Many commodities are supply constrained. The cost of many hard assets is on the rise, and satisfying even current levels of demand could prove challenging for some natural resources. Rising labor costs, environmental concerns, geopolitical strife and increasing nationalism/protectionism are all adding challenges to the supply side of the equation.

All of these factors make a compelling macro case for including real assets in an investment portfolio.

Getting started: Incorporating real assets into a portfolio

Once investors have decided to include real assets in their multi-asset portfolios, the question becomes one of allocation and, eventually, tactics. The proper allocation and portfolio mix will vary based on investment objectives, risk tolerance and time horizon.

Some high-net-worth investors may gravitate toward real assets for very different reasons than endowments or foundations. For high-net-worth investors, in many cases it's simply a question of being able to hedge their lifestyle out into the future.

So how should investors go about hedging their lifestyle?

The first step is developing the right strategic allocation to real assets, which ultimately will depend on investor-specific objectives. There is no easy rule of thumb or magic formula. There are countless variables that investors and their advisers should jointly consider. Dialing in the appropriate real assets allocation is no

small task, but here are three key considerations that can help investors determine the right portfolio mix.

1. Define the “real” objectives. What role do you want real assets to play in your portfolio? Given the diversity of the investment types within the real assets category — each with different risk and liquidity characteristics — selecting the appropriate exposure requires care. Not all real assets are effective inflation hedges, just as not all provide income potential. Investors must be certain their real asset exposure is structured to deliver the benefits needed.

2. Gauge risk tolerance. Are you looking for a new source of alpha and, thus, are willing to step out further on the risk/reward spectrum, perhaps into frontier markets, illiquid private placements or early-stage infrastructure development? Or are you looking for a conservative, long-term fixed-income proxy? Real assets can fill both roles and virtually every point in between on the risk spectrum. Stress testing a portfolio under different scenarios is one way to help investors better understand their risk tolerance.

3. Understand liquidity needs. Many of the most sophisticated institutions — the early adopters and most ardent supporters of real assets — committed a cardinal sin during the global financial crisis in 2009. Many endowments and foundations with substantial allocations to alternative investments discovered they did not have adequate liquidity during the market dislocation. Lesson learned. This should be a key consideration for investors in real assets. Though many real assets are highly liquid (such as public REITs and public equities in global commodity companies, for example), there are numerous less-liquid and private vehicles that demand a long-term commitment. Some experts suggest a tiered approach to liquidity to avoid a liquidity crunch (and forced sales) in the event of a short-term market dislocation.

The tactical opportunities: Choose wisely

Selecting the appropriate tactical investments may be one of the largest risks associated with investing in this asset class — call it implementation or execution risk. Here are some of the building blocks investors can use to gain tactical real assets exposure:

- Diversified real asset strategies/funds offer exposure to baskets of real assets, sometimes narrowly focused but other times quite broad. This may be the easiest and quickest way to gain some broad-based real assets exposure, though the objectives, make-up and fee structure of each fund could vary dramatically. Some diversified real asset funds are intent on benchmarking to an inflation index and may include an allocation to TIPS, while others offer more of a total-return approach. As always, *caveat emptor*.
- Publicly traded equities of companies can offer immediate and (often) liquid exposure to any number of subsectors of real assets, including commodities producers, precious metals mining companies, agribusiness and real estate, among many others. Some investors favor the transparency, liquidity and pure access to single asset types that are offered by holding equities in these companies.
- Publicly traded REITs and other listed property funds offer relatively quick and easy exposure to virtually any segment of the real estate markets, both residential and commercial. REITs particularly are often purchased for their income potential because they are also required to distribute the vast majority of their earnings to shareholders. In addition, nontraded REITs, although less liquid, can offer significant diversification and long-term income potential.
- Direct investments in property and commodities are another option, although it is not realistic for many investors due to the size or lumpiness of such transactions. Direct investments in farmland or commercial real estate, for example, require specialized knowledge and expertise, as well as considerations of liquidity issues and transaction costs.
- Infrastructure assets can be accessed through any number of debt or equity funds, open- and closed-end mutual funds, as well as private equity and hedge funds for qualified investors.
- Energy-related master limited partnerships are often publicly traded, and focused on the extraction and transportation of oil and natural gas. Typically, these are income-focused vehicles with special tax designation, so they are required to pay out the vast majority of their earnings to their partners.
- Commodity futures strategies typically provide investors unfiltered commodity exposure through the buying or selling of futures contracts. These can be passively or actively managed mutual funds, or even hedge funds, trading in single products or baskets of commodities at the manager's discretion.

Conclusion

No single asset class is a panacea. Yet the potential benefits of real assets and their potential to deliver in both low- or high-inflation regimes are clearly making an impression on investors. Institutional investors have been at the front end of this trend, and now high-net-worth investors are gravitating toward real assets.

The benefits of real assets — diversification and protection in a crisis, inflation hedging, attractive total returns, and yield potential — underscore their potential effectiveness in investor portfolios.

Developing an appropriate allocation and then selecting the right tactical vehicles to gain the appropriate exposures pose risks. Therefore, financial advisers and consultants will prove a valuable resource to help investors navigate the challenges and maximize the potential benefits of investing in real assets. ■

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Real Estate:

Investors expand portfolio allocations to CRE

by Beth Mattson-Teig

One are the days when commercial real estate was only accessible to the ultra-wealthy. Commercial real estate (CRE) has moved more into mainstream investment portfolios, and a proliferation of new investment structures is giving individuals more options than ever before.

Growth has been fueled by wealth advisers and investors who are more educated on the benefits and opportunities that real estate offers, chief among them being attractive risk-adjusted returns, portfolio diversification, tax efficiencies and a hedge against inflation. Volatility in the stock market has propelled more capital into commercial real estate. Investors and their advisers are looking for investment alternatives that can help to stabilize portfolios amid the wild swings they are seeing in the stock market, with the added benefit of growth or income over the long term.

Perhaps the biggest factor putting a spotlight on CRE is simply yield. There has been a nearly 30-year bull market in bonds, resulting in lower yields. Over

time, money managers have looked for alternative assets that offered good yields but were not correlated to the stock market. “That has really moved commercial real estate more to the forefront,” says Mark Earley, CEO of Hines Securities. The 10-year Treasury yield was hovering at about 1.25 percent at the end of July; for example; in comparison, investors can acquire high-quality, single-tenant industrial assets with Amazon.com Inc. as a tenant at a cap rate of 4.5 percent to 5.0 percent. “So, you have a situation where you are still getting a 300–350 basis point spread over what we call a risk-free asset,” he says. “That looks pretty compelling in the marketplace today.”

“There are several factors driving interest in commercial real estate. First and foremost is opportunity,” adds Miguel Sosa, a research strategist and product specialist in alternative investments at BlueRock. There is opportunity for growth and potential outperformance in certain sectors, such as industrial, multifamily, and smaller opportunistic pockets within the specialty sector, such as data centers, life sciences and self-storage.

“Investors are aware of the rising interest-rate environment that we potentially face and the inflationary environment that we are moving into, and historically, commercial real estate has been a good inflation hedge,” says Sosa. Real estate has provided double-digit returns above its historical average following recessions, which did occur in 2020. “Lastly, commercial real estate continues to deliver very attractive, tax-efficient returns, and the yield-starved environment we are in today makes income from hard assets much more attractive,” he says.

Investors also like commercial real estate for its stability and growth. Although, publicly traded REITs were hit hard in 2008–2009, and stock prices dropped dramatically. Many of the individual assets within REIT portfolios held up to market pressures, notes Jim Condon, managing director and co-owner of Strategic Capital Cos. and president of Strategic Capital Fund Management. Over-leveraging and refinancing difficulties caused a lot of issues. When the market came back, those REITs responded well because their property fundamentals were strong, he says.

The pandemic-related downturn in 2020 had very different dynamics, including unprecedented government stimulus. As the economy continues to come back, however, a lot of momentum is in the underlying assets and the businesses. In hotels, for example, if operators are able to hang onto assets through the pandemic, they will likely benefit as travel returns. “Similar to what happened back in 2008 will probably happen again here, with a lot of good investment opportunities where you can buy in relatively inexpensively, depending on the timing and the location, and you could see some nice growth opportunities,” says Condon.

Investors find many entry points into CRE

Historically, individuals who wanted to invest in real estate were do-it-yourselfers, buying property such as a small apartment or office building. Or perhaps they knew a guy who knew a guy who was putting together a limited partnership to buy a property. These days, individual investors have a myriad of different entry points into commercial real estate in both public markets and private structures. The evolution of investment products available to individual investors has brought more options, greater transparency and lower fees, and has further fueled capital flowing into CRE.

The introduction of REITs in the 1980s opened up real estate to retail investors via stocks and mutual funds. Real estate gained further recognition as recently as five years ago when the Standard & Poor’s Dow Jones Indices elevated real estate from a subsector under “financials” to one of 11 sectors within its Global Industry Classification Standard. The rise of exchange-traded

funds (ETFs) has given investors another entry point to REITs in the public market space. According to research and analytics firm CFRA, there are 35 U.S. listed real estate ETFs, with a total of \$85 billion in assets under management as of July 15, 2021.

Those public real estate vehicles are attractive for investors who want real estate exposure but also like the liquidity they offer in being able to easily buy and sell assets. The downside to those publicly traded vehicles is that they also tend to have a higher correlation with the broader stock market and are subject to market volatility, whereas private real estate investments are not directly correlated with the stock market.



The evolution of investment products available to individual investors has brought more options, greater transparency and lower fees, and has further fueled capital flowing into CRE.

The NCREIF Property Index (NPI), which is an institutional benchmark for real estate performance, shows a 0.14 correlation to the S&P 500 over the past 20 years. “Those lower-correlated assets are important, especially during a sell-off, because they are more likely to move independently of investors’ exposures to equities,” says Sosa. In addition, since the NPI’s inception in 1978, the index has experienced 39 years of positive returns out of the total 43 years. “We think that stability and diversification potential are added benefits on top of the inflation-hedge ability,” he adds.

Private structures continue to evolve

In the past decade, there has been explosive growth in private real estate investment structures that are open to accredited and qualified investors. A number of RIAs, for example, now offer “feeder funds” that aggregate investor capital to meet the larger minimum investment amounts required by some institutional funds, which typically range between \$250,000 and \$1 million. At the other end of the spectrum, some private real estate funds and nonlisted REITs that invest in real estate directly offer minimum investment amounts as low as \$2,500 or \$5,000. “That has really democratized the investment landscape for individual investors,” says Earley.



A key turning point for private real estate investment vehicles was the Jumpstart Our Business Start-ups Act, or JOBS Act, of 2012. Rule 506 (c) under Regulation D Section 201 (a) removed pre-existing SEC restrictions and effectively allowed real estate sponsors to start marketing and advertising to the general public. “By doing that, it has allowed for more visibility and access into the real estate investment marketplace,” says Alexander Anderson, director of Time Equities, a real estate investment, development and asset management firm based in New York City.

A growing number of private-equity fund structures now allow investors to access high-quality, professionally managed institutional real estate assets at a lower investment amount, compared with investing in a wholly owned property or a private partnership. TEI has offered a series of diversified investment funds, for example, that allows individual investors from the RIA and broker-dealer channels to co-invest alongside TEI’s own internal capital. The typical minimum investment amount for HNWIs and accredited investors is \$50,000.

Other efficient vehicles for individual investors to access private real estate investment opportunities are the Investment Company Act of 1940 (‘40 Act) registered interval funds. These funds are often grouped with closed-end funds or public non-traded REITs, but they are very different. They offer the same protections that a ‘40 Act regulated fund offers, such as restrictions on leverage and having an independent board of trustees. They tend to be large and well diversified by geography and sector, they are continuously offered with obligatory liquidity windows, and they have daily NAV pricing.

Capital branches out to specialty sectors

Commercial real estate investors have traditionally focused on four main property types — office, industrial, multifamily and retail. Multifamily and industrial, in particular, have been garnering the most attention in recent years. “It’s hard to argue against the macro trends of multifamily and industrial,” says Earley. Statistics continue to show a housing shortage that could persist for the next five to eight years, and rent collections held up well during the pandemic.

Interest in industrial has risen along with ecommerce and growing demand for warehouse, as well as logistics, fulfillment centers and last-mile distribution centers. “If you go back even a few years ago, industrial wasn’t that hot of an asset class, but with the entrance of Amazon and other credit tenants that are leasing large amounts of industrial space and creating single-tenant, triple-net investment property, the industrial space has become increasingly popular for this reason,” says Anderson.

As investors continue to grow allocations to commercial real estate, they are looking to expand into other sub-asset classes and specialty sectors, such as seniors housing, student housing, manufactured housing, single-family rentals, self-storage, lodging, data centers, cell towers, casinos, and others. Those investments help to further diversify real estate exposure, and they also offer opportunities for appreciation and income.

“Real estate sectors perform differently at different economic stages. Staying ahead of these stages can lead asset managers and investors to experience outsize performance,” says Sosa. Of the big four categories, Bluerock is most optimistic about industrial and multifamily, and is more underweighted in office and retail. “We think the interest in specialty sectors is driven by the continued search for opportunities with long-term embedded tailwinds,” he adds.

Life sciences is one specialty sector that has experienced an uptick in investor demand. “There is tremendous interest overall in biotech companies that are being funded privately and publicly. On the supply side, life sciences real estate is very constrained,” says Sosa. That is due, in part, to the hubs where research is being done, such as the San Francisco Bay Area, San Diego, Cambridge-Boston, and Washington, D.C. These are all expensive, space-constrained markets that present opportunities for owners and operators who can gain a foothold with assets. “That is one sector where we see significant structural tailwinds that may persist for some time, and where there is significant investor interest,” he says.

Digital infrastructure also is piquing more investor interest. Demand that existed pre-COVID for assets such as data centers and cell towers exploded with the shift to work-from-home. Even people who were not comfortable with embracing new technology quickly got up to speed with Zoom calls and sharing documents via the cloud. “I think everyone has a better understanding of why this infrastructure plays a vital role,” says Condon. In turn, that is driving massive demand for digital infrastructure and sparking investor interest in specialty assets, such as data centers and cell towers.

Navigating the myriad of investment choices available can seem overwhelming. Some of the factors that can help guide those choices are the amount of capital one has to spend, personal risk tolerance, time horizon and investment objectives. As with any investment, it is important to conduct thorough due diligence.

“My biggest concern with all of this supply of new real estate investment opportunities is the quality of the sponsor/operator, the substance of their performance track record and transparency of the underwriting,” says Anderson. Some investors get caught up chasing higher returns or quick exits where a sponsor is promising that money will be returned in two or three years. “You really have to look at who you are investing with,” he says.

Who is the sponsor? What is their track record? What is their expertise? What is their financial backing? How do they underwrite investment properties? At the end of the day, investing with the sponsor who is promising a higher return also comes with a higher risk of losing your money or returns not meeting expectations, he adds. □

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Energy: *The future of alternatives and renewables*

by Reg Clodfelter

The first challenge with investing in energy is simple: figuring out why you are investing in energy. While the assets and companies that make up the sector are unified around one purpose — powering the world around us — energy investments have no one *raison d'être* for your portfolio. Do you need yield? Growth? Tax efficiency? The sector offers a little something for every bucket.

The second challenge: marrying those goals to one of the litany of industry subsectors. “Energy investments are unique in that they take many forms. There is no one answer to ‘What am I buying?’” says Matthew Iak, executive vice president of U.S. Energy Development Corp. (USED), a diversified exploration and production operating firm with assets located across 13 states and multiple oil and natural gas basins.

You could, for example, be buying the underground real estate beneath someone else’s property, collecting fees on an oil pipeline or investing in a Chinese battery company. There are so many ways

to slice the sector — fuel vs. electricity, private vs. public, renewable vs. fossil fuels, upstream vs. midstream, generation vs. storage — and so many inputs to monitor, from the price of feedstocks to the threat to subsidies posed by upcoming elections, that finding an entry point can feel daunting. But in a rough sense, the sector has two main classifications with moderate internal correlation: fossil fuels and renewables, and divergent public and private strategies within each.

Despite the surge of solar and wind power over the past two decades, fossil fuels are still the primary way we consume energy, accounting for nearly 80 percent of U.S. energy use, according to the U.S. Energy Information Administration (EIA). Petroleum is our largest source at 35 percent of total consumption, with natural gas not far behind at 34 percent and coal delivering 10 percent. The rest is split between nuclear energy at 9 percent and all renewables, which make up the final 12 percent.

As for many industries, 2020 was a challenging year for energy, especially fossil fuels. The entire sector saw a 20 percent drop in investment as the

pandemic froze markets and disrupted the global economy. Worldwide demand for petroleum and other liquid fuels dropped 9 percent in 2020 — the largest drop ever recorded by the EIA dating back to 1980 — and is not expected to exceed 2019 levels until 2022. Still, even in a pandemic-ravaged year, global energy investment topped \$1.5 trillion and is forecast to hit \$1.9 trillion in 2021, according to the International Energy Agency.

Renewable energy, on the other hand, was a rare winner in 2020 — especially on the public side — with renewable companies surging after a March dip and crescendoing after Biden's election in November. The S&P Global Clean Energy Index ended the year with a 137.82 percent total return in spite of the large drop in March. But the tide has already begun receding. A chunk of those gains has been given back in 2021, as many fear the industry was a little out over its skis, and some analysts have begun talking about a green bubble.

Investors interested in adding energy to their portfolios will need to monitor how both fossil fuels and renewables push forward in a post-pandemic landscape, as well as how major upcoming federal legislation shapes those recoveries — and that's after determining their reasons for adding energy to their portfolios in the first place.

Fossil fuels

Mapping the performance of fossil fuel investments in the 21st century is a bit like tracking the course of your favorite Six Flags rollercoaster. The technological advances of directional drilling and hydraulic fracturing in the late 2000s sparked a boom that saw natural gas production in the United States increase by 50 percent from 2007 to 2014 and oil production nearly double over the same period. Returns ballooned throughout the public and private world, and capital chasing those gains flooded into the space. Then came 2014. The price of crude oil dropped more than 45 percent that year and 30 percent the following year, sparking a downturn that the industry is still wading out of.

Over the past decade, the S&P Energy Sector gained only 1 percent, while the broader market gained 212 percent. This underperformance saw the oil and gas sector fall from 29.0 percent of the S&P 500 in 1980 to a mere 5.3 percent in 2018, its lowest mark over that span.

"We are at a nadir of the market," explains Iak, with USED. "It sounds contradictory to be in oil and gas and say 'low-risk,' but it is more of a value play and a high-dividend play [at this moment].

The reality is that the industry has seen the reckoning because of too much capital in the space. Now there is not enough interest or money in the space, which is resulting in an abundant amount of excellent investment returns right now."

At the moment, public fossil-fuel investments are essentially confined to a yield play. The Alerian MLP Index, which tracks the performance of primarily midstream master limited partnerships — one of the main entryways to public real assets in energy — has seen a 10-year price return of only 1.1 percent but a 7.3 percent yield over that time. But with oil prices sharply rising and total active rigs dropping to less than a quarter of their 21st-century peak in 2007, there may be room for more than yield, going forward.

"We are not exiting; we are a buyer in this environment," says Bob Howard, founder and president of Resource Royalty, a firm focused on acquiring oil and gas mineral rights and royalty properties. "Mineral rights compare very favorably with conservative real estate, but you have the added component of the volatility of the price of oil and gas," Howard adds.

Despite these similarities, private energy investments, like the mineral rights acquired by firms such as Resource Royalty, may have a different role in your portfolio altogether: tax planning. Investments



Renewable energy was a rare winner in 2020, with renewable companies surging after a March dip and crescendoing after Biden's election in November.

into the land below ground level are real estate to the IRS and count as a like-kind investment for tax purposes. Investors are also allowed to deduct 15 percent of revenues from these holdings as the excess of percentage over cost depletion. The most-used deduction available to private energy investors, at more than \$2 billion annually, intangible drilling costs, allows investors to immediately deduct 100 percent of costs not directly tied to the final operating of the oil or gas well.

But these tax-planning tools may be on the chopping block. Biden's "Made in America" tax plan could eliminate both the IDC deduction and 1031s,

S&P Sector Performance

SECTOR NAME	LAST % CHANGE ▼ (10:33 AM ET 9/10/2021)	1 DAY	5 DAY	1 MONTH	3 MONTH	YTD	1 YEAR	3 YEAR	5 YEAR	10 YEAR
Consumer discretionary (.GSPD)	+0.28%	-0.28%	+0.18%	+1.81%	+6.63%	+12.88%	+23.07%	+60.18%	+130.90%	-
Materials (.GSPM)	+0.28%	+0.07%	-1.70%	-0.42%	-3.45%	+15.41%	+32.66%	+42.33%	+72.07%	-
Communication services (.GSPL)	+0.11%	-0.33%	-0.89%	+3.83%	+10.19%	+28.82%	+43.17%	+85.52%	+63.48%	-
Information technology (.GSPT)	0.00%	-0.42%	-0.47%	+2.03%	+12.95%	+21.06%	+40.14%	+115.29%	+252.36%	-
Energy (.GSPE)	-0.13%	+0.12%	+0.21%	-4.45%	-14.14%	+24.96%	+42.64%	-33.16%	-32.08%	-27.82%
Industrials (.GSPI)	-0.25%	-0.47%	-1.68%	-1.31%	-2.36%	+15.23%	+34.29%	+32.93%	+70.19%	-
Consumer staples (.GSPS)	-0.44%	-0.61%	-0.61%	+1.72%	+3.06%	+7.33%	+13.82%	+34.19%	+34.89%	-
Financials (.GSPF)	-0.44%	+0.25%	-0.96%	-0.20%	-0.82%	+27.91%	+53.62%	+33.86%	+90.40%	-
Health care (.GSPA)	-0.61%	-1.17%	-0.64%	+0.96%	+10.09%	+18.11%	+29.34%	+46.42%	+85.82%	+311.86%
Utilities (.GSPU)	-0.85%	-0.58%	-0.19%	+2.32%	+6.92%	+9.92%	+17.68%	+28.76%	+38.11%	-
Real estate (.GSPRE)	-0.92%	-2.12%	-2.23%	+1.41%	+4.97%	+29.96%	+33.67%	+43.84%	-	-
S&P 500 Index (.SPX)	-0.19%	-0.46%	-0.68%	+1.28%	+6.29%	+19.63%	+34.86%	+56.47%	+105.99%	+278.89%

Source: Fidelity.com

though sources for this story indicated the former is much more likely than the latter. While investors would still be able to deduct the same costs over the long haul, eliminating the IDC deduction could dry up a significant portion of the 40 percent of upstream drilling investment that utilizes this break as an offset. It will be a pivotal few years for traditional energy as it claws back to past heights while trying to keep renewables at bay.

Renewables

Like oil and gas, renewable energy investments present divergent strategies between the public and private markets. Investing in public renewables is a bet on the long-term ability of solar and wind to gobble up a much larger part of the consumption pie in the coming years, both in the United States and abroad. While investors may have proven a little overeager in late 2020, the long-term trajectory points upward as long as governments continue to see renewable energy as a necessary response to climate change — and provide policies that accommodate that response.

Similar to oil and gas, excitement around renewable energy saw global investment volumes double between 2007 and 2015 to more than \$300 billion annually. But unlike traditional energy, those numbers have held firm in the latter half of the decade.

“The overwhelming trend in the energy sector has been the movement towards more-sustainable and less-polluting ways of generating energy,” says David Sher, co-CEO of Greenbacker Capital. Sher expects this trend to accelerate over the next five to 10 years.

As opposed to public renewable investments, which are primarily growth plays, private investments in renewable energy infrastructure, like those done by Greenbacker, are designed to be a relatively low-risk, steady distribution business. These strategies marry investment capital to income-producing solar and wind farms that have long-term contracts with high-credit clients, such as municipalities and utilities.

“A long-term planning mentality is a necessity with these energy infrastructure investments,” explains Sher, pointing to the fact the annual returns on infrastructure investments tend to be recouped over the course of



years. These investments can also provide investors with tax incentives. The solar investment tax credit (ITC), for example, grants owners a dollar-for-dollar tax reduction on costs up to 26 percent. While this credit is currently set to step down after 2022, renewable tax credits have proven resilient in both Republican and Democrat administrations, and credits such as the solar ITC will likely be extended in the upcoming infrastructure bill.

Although they still cannot produce power at the cost of fossils, technological advances have allowed renewables to produce four times as much

power per dollar as a decade ago, growth that should continue moving forward.

Whether you need tax planning, income, growth or all of the above, energy provides many arrows for your quiver to aim at, whatever target you have for your real assets investments. You just have to figure out what you want from your energy investments in the first place. ▣

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Infrastructure: *Taking a seat at the table*

by Sheila Hopkins

Not long ago, it would have been the rare investor who looked at bridges, roads, airports, cell towers, and other large bulky edifices and thought, “That looks like something I should add to my retirement portfolio.” But after months of hearing about the proposed \$2 trillion (now \$1 trillion) of infrastructure investment being bandied about in Congress, and reading almost daily of bridges and roads needing repairs to prevent collapse — a 2021 report by the American Society of Civil Engineers found that more than 20,000 concrete bridges across the United States are structurally deficient, and nearly half the nation’s public roadways are in “poor” or “mediocre” condition — investors are beginning to realize that infrastructure assets might present a very attractive opportunity. But questions remain.

Isn’t infrastructure just big real estate?

Investors have been adding real estate to their portfolios for more than 25 years. They understand it well.

So, when they consider infrastructure, it is normal for them to simply see a bigger, bulkier version of what they already know. But infrastructure is its own, very distinct asset class. It’s not just real estate on steroids.

Infrastructure is traditionally defined as the system of buildings and networks that allows a society to function. Managers and investors often divide the asset class into somewhat flexible subsectors sharing similar characteristics, with some assets spanning more than one category. Utilities, for example, could fit into both traditional and energy subsectors. And some, such as warehouses and data centers, could be both real estate and infrastructure. But in general, infrastructure tends to break down along the following lines:

- Traditional infrastructure, such as utilities and transportation
- Communications infrastructure, such as data centers, cell towers and transmission lines
- Energy infrastructure, such as pipelines, power lines, generation facilities, electric-car charging stations, wind turbines and solar farms

- Social infrastructure, such as hospitals, schools, daycare centers and prisons

It is obvious infrastructure covers a wide range of assets, each with its own risk-return profile. In fact, one of the things that sets infrastructure apart from other asset classes is the variation of profiles found within a subsector. Risk-and-return characteristics can vary widely between two similar assets, depending on how each is financed, how the returns are generated, and how each is managed.

But a few common characteristics underlie the asset class and make it fundamentally different from real estate. First of all, by definition, infrastructure is necessary to the efficient functioning of a society. That means there will always be demand. People are always going to need electricity, water and roads. Specific subsectors, such as toll roads, might see a falloff during unusual times, such as COVID, but in general, demand for infrastructure is constant — or growing — in all economic environments.

In addition, because of their size and their cost to build, infrastructure assets tend to have extremely high barriers to entry. You simply aren't going to suddenly find a new airport or subway being built next to an existing one. This monopolistic feature provides stable, predictable income that is typically based on long-term contracts. This constant demand, paired with difficulty in increasing supply, gives a defensive profile that can provide a certainty of returns and smooth volatility in a portfolio.

"Infrastructure assets have barriers to entry and pricing power, which can provide investors with real income and structural growth over the medium term," says Peter Meany, head of global listed infrastructure, First Sentier Investors. "Toll roads, airports, utilities and cell towers provide essential services we rely on every day. The business models are easy to understand, and the assets will be generating cash flows for decades to come. The need for investment is enormous as society tries to solve issues ranging from urban congestion and energy security to climate change and cyber threats. In the right political and regulatory environment, this investment creates the opportunity for strong returns at reasonable risk."

Why should private investors be particularly interested in infrastructure today?

Because of its long-term contracts, which are often index-linked, infrastructure is viewed as an income-producing asset class, as well as a hedge against inflation. Income tends to be predictable and certain, with returns coming in above fixed-income levels. In the low interest-rate

environment that we've all been living in for years, having an investment in your portfolio with fixed-income stability but better-than-fixed-income returns is very attractive.

"Listed infrastructure produces a stable, equity-like stream of returns that is generally more defensive than the broad equity markets," explains Evan Serton, senior vice president and senior portfolio specialist at Cohen & Steers. "Investors get the substantial benefits of owning stocks with meaningfully lower volatility, especially downside volatility. Historically, when broad stocks are down, listed infrastructure stocks tend to be down only half as much. So you've got a defensiveness built into this asset class that can smooth out the volatility of an overall portfolio."

Regulated utilities are a particularly stable, income-producing sector. Investors who would like



Infrastructure assets have barriers to entry and pricing power, which can provide investors with real income and structural growth over the medium term.

to layer growth on top of income, however, can find value-added and opportunistic assets as well. These are especially prevalent in the technology side of the asset class, which features assets serving the growing digitization of the country, such as data centers, renewables and electric-car charging stations.

Although interest rates have been low for more than a decade, the country is currently experiencing a bump in inflation. How long it will last is a topic of hot debate, but given how long we have lived with a low interest-rate environment, it seems safe to say rates will go up.

"Following the COVID-19 pandemic, central banks and governments have aggressively stimulated their economies," notes Jane Seto, head of private infrastructure equity, North America at DWS. "Investors may need to prepare for a period of rising inflation and yields after more than a decade of structural decline. For infrastructure investment, such a scenario shall not be feared, but may translate into an advantage for investors."

This is because regulated infrastructure assets are often index-linked, with regulators



allowing investors to recover inflation and interest-rate increases in their returns, supporting dividend-yield predictability.

“Moreover,” Seto continues, “the likely result of this aggressive policy stimulus is also a possible acceleration in global growth, and in some key megatrends, such as decarbonization and digitalization. For investors focusing on capital appreciation beyond yield, this represents an ideal environment to invest in infrastructure assets, where cash flows have potential to increase with the cyclical upswing in the economy, or supported by structural long-term growth, such as digital infrastructure and renewables.”

How can an individual investor access infrastructure?

In the past, infrastructure investment was the province of only the largest institutions because it was simply too expensive for individual investors — or even most institutions — to access. But that has changed as managers have launched listed funds, exchange-traded funds and mutual funds. These vehicles provide a diversified basket of infrastructure assets, as well as professional management. Investors can look for funds that invest in multiple sectors, or concentrate their investment on a single sector, such as transportation, communications or renewables. In addition, these funds give investors the opportunity to invest globally or within a single region, such as North America.

“The range of investment opportunities continues to widen across a broader spectrum of infrastructure strategies and sectors with different risk-return characteristics,” says Seto. “In our view, private infrastructure funds will play an essential role in contributing to support pure-play strategies [investing in the owners and operators of infrastructure assets], increasingly focusing on infrastructure assets deemed essential to accelerate the energy transition process. Often, these assets, despite displaying solid infrastructure investment characteristics, cannot be accessed with the same depth in listed markets. Moreover, with sustainable infrastructure assets increasingly pivoting toward core-plus and value-added infrastructure strategies, and demand for these strategies growing, the expertise of private infrastructure funds managers may be essential for the asset-selection process, the selection of managers capable of supporting resilient long-term asset growth, and to ensure a well-diversified portfolio construction process supporting cash-flow resilience.”

What are some of the opportunities today?

Although infrastructure is a widely diversified asset class of stable assets, some sectors will do better than others in today’s economic climate.

“We are seeing three major opportunities, two of them secular, one of them more cyclical,” says Serton. “First, the digitalization of the economy presents multiple opportunities in the

communication segment of our market; for example, investments in listed data center and cell tower companies. Second, the greater demand for renewable energy sources and the potential drivers from a policy perspective coming out of Washington, provide significant opportunities for sustainable energy developers. And then three, the current post-COVID economic growth is spurring investment in more cyclically oriented infrastructure companies, such as freight rails.”

There is a general, inexorable movement to improve infrastructure that is opening opportunities on multiple fronts. The infrastructure bill currently in Congress is just the tip of the iceberg.

First Sentier Investors’ Meany says the 10-year extension of renewable tax credits, for example, will support targeted investment in wind and solar, accelerate the reduction of carbon emissions, and allow for critical investment in building a more resilient and flexible grid.

“Earnings growth for utilities has probably risen from 5 percent to 7 percent for the next decade,” adds Meany. “To add capacity for growth, governments will need to leverage private capital, and we see

opportunities for listed infrastructure companies to invest in new express lanes or airport terminals.”

If investors are interested in investing in infrastructure, they can undoubtedly find a fund that meets their risk-and-return specifications, while focusing on a sector and region that present attractive opportunities.

Bottom line

Infrastructure has been allowing civilizations to function and grow since the first village installed a system to bring water up from the ground. And it is essential in allowing civilizations to continue to grow and meet the needs of today’s and tomorrow’s populations. With the advent of exchange-traded funds, mutual funds and listed infrastructure funds, the individual investor now has the chance to take part in this essential asset class — just as the big guys have been doing for years. ▣

Sheila Hopkins is a freelance writer based in Auburn, Ala.



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The background of the top half of the page is a photograph of several oil pumpjacks in an oil field. The scene is captured at sunset or sunrise, with a warm orange and yellow glow. The pumpjacks are silhouetted against the bright sky. The title text is overlaid on this image.

Commodities: *Early in the boom?*

by Benjamin Cole

Are commodities the last refuge for the investor's dollar — and possibly due for a long, secular bull run? If past is prologue, then the answer is yes.

As the world emerges from its COVID-19-related purgatory and economic slowdown, capital around the globe is looking for a place to stay but finding most rooms dearly priced.

Global central banks have been accommodative, lowering interest rates and subsequently boosting asset values, in a bid to keep economies from crumbling.

In such an environment, the stocks that make up the S&P 500, that broad index of listed U.S. blue-chip enterprises, traded for a lofty 35 times present earnings in midyear 2021. That is an evaluation one might have expected to pay for a growth stock in another era.

Yields on secure government bonds are low, and sometimes *negative*. The 10-year U.S. Treasuries offer a scant 1.25 percent, while German 10-year bonds offer -0.45 percent.

Property is always a worthy alternative to securities but challenging in the present, with logistics and housing fully priced and other categories uncertain, as work-from-home and online shopping habits gain ground.

But one sector may be only on the first leg of a long run.

Commodities

Just after midyear, Wells Fargo Investment Institute issued a report titled *The new commodity super cycle bull* — guaranteed to grab the eyeballs of any investor looking for a place to place funds.

The old adage “Bear dives are the mother of bull runs” is true, advised Wells Fargo. For example, when returns are low in oil patch, then investment lags, and ultimately output declines. At some point, the screw turns; then scarcity and shortages emerge, and prices soar to drive the next investment cycle.

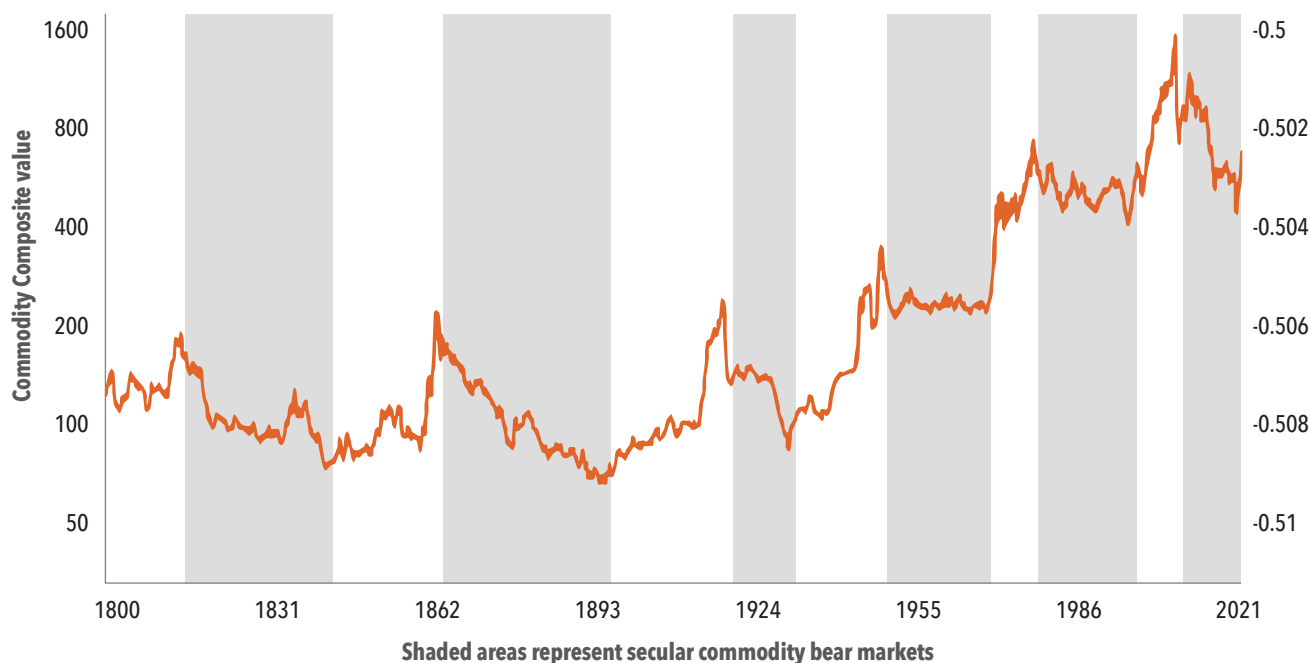
That same story roughly plays out in many other commodities as well, from agriculture to metals to chemicals.

As can be seen in the accompanying Wells Fargo chart (page 20), every commodity swoon has been followed by a rush of higher prices— much higher. Since 1840, no commodity bull market, as measured by prices, has failed to rise by less than 200 percent, and in the most recent bull run, ending in 2009, commodity price index rose nearly 300 percent.

In the ongoing broad commodities upswing, prices are up “only” about 60 percent, the report noted, and prices only started turning up in 2019.

It added, “average commodity bull market returned 237 percent over 15.9 years.”

Commodity bear market super cycles



Source: Wells Fargo

By that metric, the commodities rally is still in the early innings.

Ways to play

Depending on how intrepid the investor or adviser is, there are various pathways into the commodities play. The usual entrances into the market are generally ranked according to risk:

- Commodity-index funds
- Commodity-oriented stocks and ETFs
- Direct ownership of resource lands, usually farms

(Investors can also play commodity futures and options, and such strategies can conservatively hedge a portfolio. But, in general, futures and options are more for speculators than investors, and are not addressed here.)

Commodity index funds

The granddaddy of commodity-index exchange-traded funds (ETFs) is the S&P GSCI Fund (SPGSCI), which invests in 24 commodity index that reflect the global commodity market. For investors who want to wager on commodities and skip the details, the S&P

GSCI Fund or other broad-based commodity index funds may be right.

Another advantage for those with large amounts of capital: Getting out of the S&P GSCI Fund is but a mouseclick away, a very liquid proposition — a different play from buying a stake in a copper mine, direct gold bullion or a farming operation. In a world where fortunes may turn on a (silver) dime, liquidity is a virtue.

Commodity stocks and ETFs

There are many commodity stocks on Wall Street, although the gold and oil sectors remain the most prominent categories.

Gold always has its adherents, and with central banks globally printing money to battle the COVID-19 recession, the yellow metal may have another big day in the sun.

Interestingly, there are times when gold miners do even better than gold bullion.

The basic reason for this better performance in rally times: A mining company might lose money at \$1,400 an ounce for gold, break even at \$1,600 and become immensely profitable at \$1,800 an ounce. All the cash earned past the \$1,600-an-ounce break-even level drops to the bottom line.



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After an industry study, global money manager VanEck recently posited a \$200 increase in gold prices results in “60 percent increases in free cash flow, on average,” for larger gold-mining enterprises.

If so, Newmont Corp. (NEM), the world’s largest gold-mining enterprise, may be worth a long look.

Newmont shares have been muted in recent years, with gold trading today about the same price as 10 years ago. That long dormancy could spell a buying opportunity, and meanwhile, investors have been paid to wait: The miner throws off a 3.5 percent dividend and has a 10-year track record of boosting payouts. So, Newmont promises a way to “own gold” and collect a dividend.

For those who want to diversify among gold-mining issues, there are ETFs, including the iShares Gold Producers UCITS ETF (LSE:IAUP), which owns several gold-mining issues.

Another diverse play in gold is the Sprott Gold Miners ETF (SGDM), which holds a portfolio of more than 25 gold and silver miners, and pays a modest dividend as well.

Black gold

Several circumspect long-time observers of the oil industry scene believe there is strength in the market through at least the next few years and possibly long term, even as climate change rules and electric cars enter the market.

“Cumulatively, fossil fuels still accounted for 83.1 percent of the world’s primary energy consumption in 2020,” notes Robert Rapier, director at Chandler, Ariz.-based Proteum Energy and a commentator for *Forbes* magazine.

There are decades to go to substantially reduce that dependence, and meanwhile, gigantic demand for oil could outstrip supply, especially if economies improve but supply is constrained, said Rapier.

The overwhelming fundamental about oil is that as global incomes rise, oil consumption rises even more. As China, India and Southeast Asia develop, fossil fuel demand will increase also. While green regulations and electric cars will blunt oil demand, that scenario is still years ahead.

Moreover, energy regulation may not only curtail demand, but also supply. “We’re seeing stakeholders push hard on oil producers, and companies are responding by not producing what they normally would,” observes John LaForge, head of real asset strategy, Wells Fargo Investment Institute.

For those seeking diversity among commodities, but also want to preserve capital, some of the oil majors come to mind.

No one needs introduction to Exxon Mobil Corp. (XOM), the integrated oil giant sporting a market cap near \$250 billion. The stock may go up with a

commodity bull, but meanwhile, investors can collect a 6.10 percent dividend, compared with the 10-year U.S. Treasury yield of 1.25 percent. And unlike Treasuries, Exxon’s payout may grow in the future.

A less-risky play than Exxon is the SPDR S&P Oil & Gas Exploration & Production ETF (XOP), which invests in oil-and-gas-producer stocks. Though the ETF has rallied mightily in the past year, it is still far below highs seen back in 2014. The dividends are modest at about 1.70 percent, though higher than 10-year Treasuries.

Sign of the times

Rio Tinto (ASX:RIO), the world’s second-largest metals and mining enterprise, known especially for its iron ore operations in Australia, in late July 2021 reported a record first-half profit of \$12.1 billion and a \$9.1 billion dividend, as Sino demand drove the price of the steel-production raw material to record highs. The metals concern declared an ordinary half-year dividend of \$3.76 a share and a special dividend of \$1.85 a share — on a stock trading at less than \$100 a share, while shares traded at an all-time high. Rio Tinto is an example of how a listed commodity company with operations, as opposed to commodity price index, can surge in bull markets, and pay solid dividends along the way.

Diversity is strength

Although it is possible to hit a home run with an Exxon Mobil or Rio Tinto, investing in a mixed portfolio of commodities, or commodity stocks, is a sensible option, advise experts.

It can be precarious to make bets on specific commodities, as opposed to the whole sector. “During commodity bull super cycles, a basket of diverse commodities is the way to go,” advises LaForge. “Leadership will often change.”

Gold was hot mid-2020, but since then, oil and industrial metals have come to the fore, noted LaForge.

For those seeking diversity among commodity-producing enterprises, the SPDR S&P Global Natural Resources ETF (GNR) invests in 90 of the largest global companies that produce timber, oil, gold, iron ore and other natural resources or commodities. As of early August, the ETF is up nearly 40 percent year-over-year, although its performance during the last 10 years has wobbled, along with the soft commodities market. Still, with this ETF, not only do investors get a broad-based exposure to commodities, but they also collect a dividend of 2.74 percent.

“We believe a diversified exposure to commodities is the best way for investors to benefit from upside across all different commodities,” says Darwei Kung, head of commodities and portfolio manager at DWS, the German-based money manager.

Kung notes the global population is projected to reach 8.5 billion in 2030 before marching to 9.7 billion in 2050 and 11.2 billion by 2100, by U.N. projections. Inevitably, demand for natural resources and commodities will keep apace.

Farming/timber

Not everyone wants to put on overalls and participate in a commodity investment directly, as in growing corn.

One path into owning farmland is to execute a sale-leaseback transaction. For this, the investor should seek expert counsel and align with a farmer who wants to sell and rent thereafter. The annual returns are likely modest, but the land will generate a return while the buyer waits for the asset to appreciate.

A few farm stocks are on Wall Street, including Farmland Partners (FPI), a REIT. The stock has rallied in the last year, roughly doubling, but is still below its 2014 IPO price. Farmland Partners does pay a 1.59 percent dividend, and certainly the shares have been moving in the right direction.

Timber is another commodity that has fared well recently. Strong lumber demand and escalating lumber prices are fueling positive results for timber firms and investors. There are four publicly traded timber REITs:

Weyerhaeuser Co., Rayonier, PotlatchDeltic Corp. and CatchMark Timber Trust. As a group, the sector recorded a healthy 10.3 percent total return in 2020, and that strong performance has continued in 2021, as timber REITs posted a 10.6 percent return through the first eight months of the year. In addition, there are a number of timber ETFs, such as iShares Global Timber & Forestry (up more than 13 percent year-to-date) and Invesco MSCI Global Timber (up more than 15 percent YTD). Keep in mind, however, like most commodities, timber is a highly cyclical investment.

Conclusion

The history of commodity investing is checkered, from oil gushers to salted mines to silver strikes to crop busts. Fortunately, today's investor has access to liquid investment vehicles and diversification, and to advice from investment professionals.

With sensible planning, investors may pursue heavier exposure in their portfolios to commodities while remaining protected against the unexpected declines in any particular commodities sector through diversification. ▣

Benjamin Cole is a freelance writer based in Singapore.



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by Mike Consol

Though asset classes such as real estate, infrastructure, energy and commodities tend to dominate real asset investment, a broad array of other investment opportunities for the portfolio can do investors a tremendous amount of good, in terms of both performance and diversification. These range from private equity, hedge funds and venture capital to farmland and a host of disruptive technologies and so-called exotic alternatives.

The many other *real assets and alternatives at investors' disposal*



Private equity funds make capital available to acquire companies, develop new products and technologies, provide working capital, or strengthen a company's balance sheet. PE now represents more than \$4 trillion in investable assets — roughly 40 percent of that in dry powder.

Private equity's consistent long-term outperformance against major indexes is well documented, with the asset class generating 597 basis points of outperformance over a 20-year period and 489 basis points over a 15-year period versus the S&P 500. What's more, significant historical data show that private equity's outperformance actually increases during distressed periods.

Little surprise that PE has seen an influx of investors in recent years, many of whom are new to the asset class.

The ability of private equity firms to plan and invest over the long term, particularly relative to public companies, confers several advantages that are at the root of the class's outperformance. PE firms can take a buy-and-build approach to consolidate a sector, using the same dry powder to make add-on acquisitions at a time when purchase-price multiples are low. This can be particularly effective in down markets.

Before getting too excited, however, investors must be willing to commit a substantial amount of cash to play in the high-stakes world of private equity. Investopedia reports \$25 million is a typical PE commitment from investors, though some funds will give investors access for as little as \$250,000. Investors should also plan to hold their PE investment for at least 10 years, while keeping in mind that PE funds will be investing their money in (among other things) early-stage, high-risk ventures, usually in sectors such as software and healthcare.

However, there are in-direct ways to invest in private equity, such as through funds of funds, ETFs and special purposes acquisition companies (more often referred to as SPACs).

Hedge funds are also not for the faint of heart, though their performance, like PE funds, can be stellar when well managed.

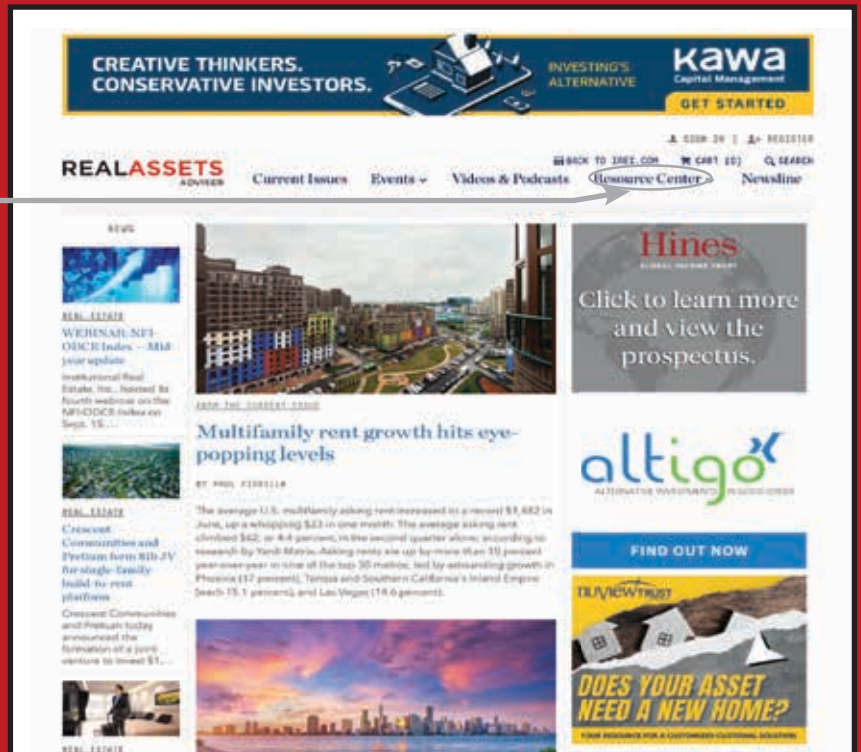
The Motley Fool defines a hedge fund as a partnership that invests its clients' money in alternative investments to either beat the market or provide a hedge against unforeseen market changes. A hedge fund is typically structured as a limited partnership. Third-party investors, such as pension funds, banks, and wealthy individuals and families, invest in the partnership as limited partners, while the hedge fund management group serves as the general partner.

The use of hedge funds in financial portfolios has grown dramatically in recent decades, taking off in the 1990s when high-profile money managers deserted the mutual fund industry for fame and fortune as hedge fund managers. Since then, the industry has grown substantially, with total assets under management valued at more than \$3.25 trillion. According to Barclays, the total AUM of hedge funds jumped by 2,350 percent between 1997 and 2019.

Lisa Vioni, CEO of Hedge Connection, a hedge fund trade group, defines a hedge fund as a private investment vehicle (private placement) designed to protect investors during market volatility, while generating positive returns in up-and-down markets. It is structured as a limited partnership composed of a group of investors and managed by a fund manager. The goal of the manager is to maximize returns while minimizing risk.

Hedge funds can invest in almost anything — including stocks, bonds, options and cryptocurrencies — and may invest in highly illiquid and obscure securities, making the investment strategy risky. Unlike an open-end mutual fund or ETF, a hedge fund is not regulated. Because of the liquidity risks associated with hedge funds, investors must meet certain criteria before they can legally qualify to invest in the fund. Each investor must be verified to be an accredited investor.

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Venture capital, another hot alternative category for the well-heeled and intrepid investor, is a classic high-risk, high-reward opportunity. VC firms invest in startup companies, most of which either fail or never live up to their promise. It is the one or two out of 10 VC-backed companies that produce substantial or spectacular returns — think Apple, Google, Facebook, etc. — that make it all worthwhile.

Venture capitalists invested \$288 billion in the first half of 2021, an all-time record, according to Crunchbase, with \$140 billion of that going to U.S.-based startups. VC firms especially like investing in scalable technology and social media companies, whether software, digital hardware, biomedical or internet-based players.

Indeed, disruptive technologies, such as fintech, AI, robotics, genomics, 3D printing, space exploration and other breakthroughs, present interesting opportunities.

Better understood is farmland investing, which is valued at more than \$3 trillion in the United States alone, with nearly zero correlation to the S&P 500. During the past 85 years, farmland has delivered 11 percent annualized returns unlevered, with roughly half of those returns coming from cash flow and half from appreciation. As an asset class, it has outperformed the stock market, private equity and venture capital, with low volatility and minimal leverage. It is expected to continue this trend in the future.

More than 54 percent of cropland is leased, making it an untapped class of commercial real estate, and there is only 14 percent debt on the entire sector, meaning a credit market crash would not turn into a stampede of farmland owners and investors heading to the sales block.

Niche investment opportunities exist in the so-called exotic alternatives space. Exotic alts — including collectibles, such as art, coins, watches, trading cards and comic books; vintage wine and Scotch; and automobiles — have outperformed the S&P 500 by wide margins during the past five and 10 years.

Other exotic alts include financial contracts, life settlements, royalties, tax liens and leases, among many other products. Litigation finance (another exotic alt where investors provide capital for one party in a contract dispute to sue another) has produced returns averaging 25 percent to 50 percent per annum in recent years, according to Kevin Mirabile, author of *Exotic Alternative Investments — Stand Alone Characteristics, Unique Risks and Portfolio Effects* and a professor of finance at Fordham University.

Mirabile pointed to some extraordinary returns on rare exotic alts, such as the 1952 Mickey Mantle baseball card that recently traded for \$5.2 million only 10 years after it had been bought for about \$2.5 million.

He also cited a piece of artwork recently released in a digital format called a non-fungible token (or NFT) that sold for \$68 million.

“Some of the other asset classes are less exciting when it comes to returns, but that’s because they may offer a yield,” says Mirabile. “Something like investing in life insurance contracts that will offer investors a very steady 8 percent to 12 percent return every year with extraordinarily low volatility and positive cash flows over time.”

Mirabile, who devotes 5 percent of his portfolio to exotic alternatives, calls the category a very eclectic mix of asset classes that share some common traits, such as being tradable, being noncorrelated, and having a source of valuation or a methodology that can be validated and is able to be verified by an independent third party.



Venture capital, another hot alternative category for the well-heeled and intrepid investor, is a classic high-risk, high-reward opportunity.

In many cases, exotic alts exist in a securitized form, such as an ETF.

“Today, family offices with high-net-worth individuals are now looking beyond traditional alternatives for a variety of reasons,” says Mirabile. “Sometimes hedge funds haven’t delivered what people expected; sometimes private equity hasn’t done as well, given its underlying risks and illiquidity. So now, many people are looking to allocate maybe 3 percent to 5 percent of their portfolios to these sorts of investments, which, ironically, are almost more accessible than investing in a hedge fund.”

For example, an investor can buy the New York Stock Exchange-traded symbol NERD, which is a pure-play esports ETF.

Taking these asset classes and product structures as a group, investors and advisers have a very broad array of options and opportunities. They would do well to consider the full gamut when building their portfolios. ■

Mike Consol is editor of *Real Assets Adviser*.

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