What are real assets, and how can they help investors?

‘Real assets’ are – exactly as their name suggests – tangible investments. Offices, industrial buildings, retail property, social housing, infrastructure projects, wind farms… all of these assets can be seen and touched. This sets them in stark contrast to ‘paper assets’ like company shares or government bonds. Returns from real assets are typically driven by two components: capital returns based on the relative demand for the asset in question (e.g. changes in central London property prices due to changes in their popularity) and the income returns that the asset creates (e.g. rental income earned through leasing a property to tenants).

As an incredibly varied set of investments, real assets have the advantage of offering different portfolio benefits at different times. Some real assets may be held for the defensive, secure income streams they produce; others may be held for the much higher (but also riskier) growth opportunities they represent.

Where can we find investible opportunities in real assets?

The broad real asset category includes many sub-sectors, from retail and office space to social and economic infrastructure. At the moment, our preference is to target income-oriented real assets with long, secure leases, and selective sub-sectors benefiting from structural growth stories.

There is more than one way to invest in real assets. For example, investors could choose to position themselves in the shares or the debt of real assets – or indeed (as we do) invest in both, depending on where they see attractive opportunities. The routes to investing in real assets are numerous too; investors could opt for actively managed funds or private equity vehicles, and/or choose the shares of listed investment companies or real estate investment trusts.

At Heartwood, we tend to avoid retail ‘open-ended’ funds, which can suffer from the ‘liquidity mismatch’ inherent in these structures (meaning investors can sometimes struggle to quickly exit their position in the fund). We are also conscious of liquidity risk in listed shares; selling shares without drastically dropping their prices can be difficult during periods of market stress, though these shares can provide useful long-term portfolio positions when held through a range of market conditions. Balancing the risks of a relatively illiquid asset class with the return potential it can offer is our primary goal.

Case study: Infrastructure

At a global level, infrastructure remains sorely under-supplied and under-funded (as shown in the chart below, which predicts infrastructure investment by 2040), which can act as a drag on economic growth. Infrastructure in developed markets requires significant levels of replacement and upgrading in order to remain fit for purpose, while emerging markets need fresh infrastructure to enable their continued development. Private sector involvement in infrastructure projects can help to fill the existing void, and investors in this area can gain exposure to long-dated, inflation-linked income streams, supported by binding contractual agreements. However, regulatory risk and changing political priorities can be problematic in some areas, particularly in publicly-financed projects; a discerning approach is therefore key.

World investment in infrastructure by 2040

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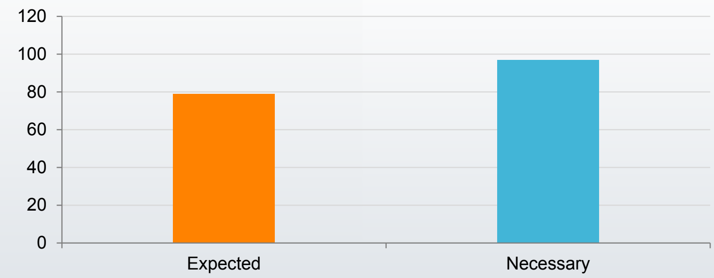


Source: World Economic Forum

Clear Thinking

Contact

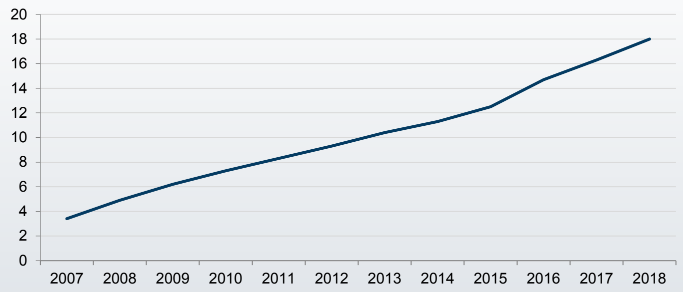
To find out more about the Heartwood strategies, visit our website or contact your local representative.

Case study: Commercial property

We believe that the era of dramatically falling yields in the commercial property sector is likely behind us, and our recent focus has been on income-oriented opportunities, and assets with the potential for rental growth. We have been actively reducing our exposure to traditional retail property, perceiving that other sub-sectors can offer attractive share price valuations while benefiting from niche growth trends. Urban warehouses in the UK are a good example of this – as online sales rise as a percentage of total retail sales, the demand for industrial storage and distribution centres in urban areas is rising too, leading to falling vacancy rates and rising rents in key urban locations.

Online retail sales have charted a steady upwards trajectory

UK online sales as a percentage of total retail sales



Source: Office for National Statistics

Case study: Real asset debt

Significant opportunities for private lenders emerged in the wake of the 2008 financial crisis, as a wave of regulatory changes and bank capital requirements saw traditional lenders step back from certain types of lending. As a result, investor options in real asset debt (via private lending vehicles) have grown rapidly.

Private real asset debt has the potential to offer investors more attractive yields than public debt markets, and is often backed by solid, legally-contracted cash flows. A significant amount of investor capital has flowed into real assets in recent years, driving down yields, but attractive returns are still available to selective investors.

Do our portfolios hold exposure to real assets?

In part due to our highly targeted approach, our portfolio exposure to real assets is selective, with positions across key sub-sectors in commercial real estate and infrastructure, where we hold both shares and debt. We consider ourselves to be careful and discerning investors, with an emphasis on fully understanding the assets in which we invest on behalf of our clients, and are always seeking opportunities within the diverse and often compelling real asset investment space.

Charu Lahiri
Investment Manager

Important Information

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