Context Capital Consulting

IMAP INDEPENDENT THOUGHT CONFERENCE

6 SEP 2022 - SYDNEY

THE ROLE OF PROPERTY AND INFRASTRUCTURE IN PORTFOLIOS

PROPERTY

ROLE IN PORTFOLIO

Inflation-linkage
Property revenues are often linked to inflation or some other escalation factor which can provide a hedge against inflation.

Diversification
Correlation with equities tends to be low over longer periods, however, can be higher in the short term especially with listed securities.

Access to structural trends
Property can provide access to an opportunity set that differs from equities, allowing investors to benefit from structural thematics, demographics and growth.

Mix of income and capital returns
Property can deliver equity-like (capital growth) and debt-like (income) characteristics, ideally with returns that sit between equities and bonds and with low long term correlation to both.

Long term nature
Property provides long-dated cash flows. This can be useful depending on investor circumstances.

PORTFOLIO CONSTRUCTION CONSIDERATIONS

Implementation
For the purposes of most retail investors advice groups, investments in property are limited to listed REITs due to liquidity and implementation constraints.

GREITs
Context prefers global property allocations. In our view there is a much wider opportunity set, and most Australian investors will have already had an existing exposure to domestic property.

Active management
Our preference is to allocate to active managers with broad global mandates and aligned definitions of real estate who are able to access emerging and opportunistic sectors. We therefore outsource to managers active decisions around sub-sector, geographic and risk exposure.

Definitions
Context's preference is to limit or eliminate exposure to real estate operating companies and property developers.

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PROPERTY

LISTED VS UNLISTED ASSET CONSIDERATIONS

Correlation between listed and unlisted property is limited in the short term but significant over the long term. Listed REITs exhibit a much higher equity market beta over shorter time periods.

This difference is attributable, at least in part, to the appraisal-based approach to unlisted property valuations which can be significantly lagged.

Listed and Unlisted market performance can differ significantly because listed markets reprice quickly and listed REITs often have higher gearing than core direct property. Overall, we believe that REITs can be a good proxy for unlisted real estate but there will be significantly higher volatility, and in the short term at least a lower level of portfolio diversification because of the higher equity beta.

In our view, there is mixed evidence as to whether an "unlisted premium" exists. In our view the benefit of direct property is lower volatility and greater diversification benefits.

Unlisted portfolios can create significant challenges for investors in stress situations.

- A need for liquidity can create a forced sale situation where assets must be sold at a discount
- Infrequent redemption windows and very long sale processes can make it difficult to rebalance portfolios opportunistically

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INFRASTRUCTURE

ROLE IN PORTFOLIO

Defensive characteristics
Context regards monopolistic and essential service infrastructure as defensive because of the highly regulated or long-term-contracted nature of cashflows such assets generate

Attractive growth potential
Infrastructure assets with links to economic activity provide attractive growth options and returns. Capital inflows and returns in this sector should remain attractive as global investors become more accepting of infrastructure as an asset class

Geographic and sector diversification
Global listed infrastructure provides access to a range of geographies and sub-sectors that provide portfolio level diversification and can lower overall portfolio volatility.

Mix of income and capital returns
Capital intensive nature of essential infrastructure means returns are typically a mix of income and capital. Infrastructure can therefore provide a stable return profile with greater yield potential than equities or bonds.

Long term nature
Essential infrastructure provides a long-dated amenity to a community or economy and is therefore well suited to investors with long horizons.

Potential for positive ESG outcomes
Renewable energy and social infrastructure assets have the potential to mitigate climate change or provide positive social outcomes.

PORTFOLIO CONSTRUCTION CONSIDERATIONS

Implementation
For the purposes of most retail investors investments in infrastructure are limited to listed securities due to liquidity and implementation constraints.

Preference for global allocations
Context's preference is for global infrastructure allocations. There is a wider opportunity set and the Australian listed market is quite constrained for a standalone investment.

Active management
Context's preference is to allocate to active managers with index unaware global mandates and aligned definitions of core infrastructure who are able to access emerging and opportunistic sectors. We outsource to managers active decisions around sub-sector, geographic exposure and risk exposure.

Definitions
Our preference is to limit or eliminate exposure to what we would define as non-core infrastructure assets.

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INFRASTRUCTURE

LISTED VS UNLISTED ASSET CONSIDERATIONS

Correlation between listed and unlisted property is limited in the short term but significant over the long term. Listed infrastructure demonstrates a higher correlation with global equity markets and higher volatility over shorter time periods and is therefore, in our view, not a perfect proxy for unlisted assets.

This is attributable, at least in part, to the valuation cycle for unlisted assets which by necessity introduces a lag with listed markets.

Listed benchmarks vary widely in construction and in general include higher risk exposures (commodities, operating businesses, non-core assets) and significant geographic and sectoral biases (e.g. US, energy). Unlisted portfolios provide a greater degree of control over portfolio construction.

Unlisted portfolios can create significant challenges for investors in stress situations.

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- Infrequent redemption windows and very long sale processes can make it difficult to rebalance portfolios opportunistically