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Commentary: Real opportunity in niche real assets

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U.S. equities are expensive by almost every valuation metric and continue to get pricier, which is why the investment case to ride the bull market is getting even harder to justify. But where else can investors go, given the number of assets correlated to U.S. equities, political uncertainty around the world and the largely unknown impact of changing monetary policy?

Institutional investors increasingly have turned to real assets. Against the current economic backdrop, real assets can make a clear and compelling investment case, in no small measure because they have limited correlation to other asset classes.

The challenge for investors is how to differentiate among the various real asset opportunity sets, as well as assessing local risks.

Niche sectors within real assets, such as emerging market infrastructure, or concept-driven real estate in European urban city centers, have the potential to generate stable cash flow, while also providing long-term return.

Africa, for example, is not overly exposed to global market conditions and it's also not highly leveraged with private debt financing. Also, development banks continue to drive investment flows to African infrastructure.

Because oil prices are low, local governments and producers have increased their focus on generating revenue from gas assets. This includes ventures that take otherwise unusable natural gas produced as a byproduct, converting it into a power source, or petrochemicals. Brownfield industrial projects in Africa like these are underutilized and cheap, which makes them an interesting long-term investment play.

On a macro level, the steady growth among the lower and middle classes in Africa, and falling commodity prices, support the development of industrial infrastructure projects. This population shift is a driving force for the rapidly growing need for infrastructure in emerging markets, one that cannot be met solely by local governments.

Globally, governments have historically played the biggest role in funding infrastructure projects. But the infrastructure funding needed per annum is \$3.3 trillion, while the current government annual infrastructure spend globally is \$2.5 trillion. This leaves emerging markets severely short of capital for infrastructure projects and offers plenty of opportunity for the private sector to play a role.

Although the case for allocating to emerging market infrastructure is compelling, these projects can come with risks and challenges. The projects must be analyzed on a case-by-case basis.

Take the example of early stage investing in Caribbean and Southeast Asian renewable energy projects, like solar and wind farms. There is a strong need for green energy in the Caribbean and Southeast Asia. Yet, there are risks to this type of infrastructure project, such as local regulatory complexities. The risks can also change throughout the life of the project.

For these types of niche investments, it is key to work with an experienced manager who has the in-house expertise to identify the right projects with the most potential. The manager must also structure the equity and debt financing, which often involves complex co-investing agreements. Expertise is also needed with local and national regulatory affairs, and in the project management, from construction through to long-term operation of the facility.

Real estate requires even more local domain knowledge and expertise. Niche real estate investment opportunities are popping up all over Europe. Key urban city centers are poised for economic growth that will support opportunities in specific

commercial and residential real estate markets.

For example, in 2015, the number of homes sold in Lisbon was 70% higher than in 2014. The residential market in Portugal is seeing one of its best performances ever recorded. Within the Portuguese residential space, student housing or "micro living" offers a particularly strong opportunity, as the country remains attractive to international students, due to its lower university tuition and cost of living.

There are numerous niche real asset opportunities, but investing in them requires specialized, regional expertise. It is important to differentiate among the various opportunities, how to best capture them for the long-term return benefits, and how to carefully assess risks. When it comes to real assets, this is all the more important in the growing niche categories.

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