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Infrastructure and commercial property luring investors

Investors are seeking alternative asset classes such as infrastructure. **Louie Douvis**

by **Alexandra Cain**

Spooked by the effect the credit crunch last decade had on portfolio values, wealthy investors have been scouring markets for good opportunities that are not correlated to the major asset classes such as shares and bonds.

A new asset class, a broad church called "alternatives", emerged to meet this need. This investment category covers a range of assets, including infrastructure, commercial property and derivative instruments.

Some of these investments carry high risk, for instance derivatives. Others, such as infrastructure, are lower down the risk spectrum. The idea is to add an alternative overlay on top of a diversified portfolio to reduce overall risk should the equities and fixed interest components of the portfolio be battered by a serious market correction.

Alex McNab, chief investment officer at Blue Sky Alternative Investments, says alternatives are becoming a mainstream part of investment portfolios, not just at an institutional level but also among high net worth investors.

"Prevailing conditions in the traditional investment markets of equities and fixed income are not particularly attractive for investors. Ultra-low interest rates globally and domestically have driven up valuations in the traditional asset classes, and history tells us that prospective returns in these asset classes are weak. In the context of these very weak prospective returns on traditional asset classes, investors are seeking different asset classes to contribute portfolio returns," he adds.

More resilient

Tim Keegan, AMP Capital's head of SMSF and self-directed wealth, explains how infrastructure as an alternative investment has the potential to enhance portfolio returns.

"While infrastructure is not immune to what occurs in the broader economy, because they provide essential services, infrastructure businesses can be much more resilient than industrial stocks and you tend to get more stable returns. Not to mention the fact that infrastructure typically operates in monopolistic environments with long-term contracts with government," he adds.

When it comes to commercial property, Keegan explains investments are backed by rent, typically around a long-term contract. "We also don't see the same levels of volatility around commercial real estate that we might see in equity markets," he says.
Within infrastructure, there's a huge opportunity for private investment because many governments are relying on these funds to build the infrastructure necessary to drive economic growth across the world.

"A lot of infrastructure was built a long time ago. It's ageing and needs to be replaced and there are significant benefits to society by investing in that infrastructure, particularly as the population grows. A wall of money needs to go into it right across the globe," says Keegan.

Different dynamics are playing out in the commercial property space. "If we look at its relative yield to the market it's still looking very attractive. The art in this market comes down to active selection. Being able to choose the right assets in the right market is very important."

Essential to be selective

George Toubia, chief investment director, Westpac Private Bank, agrees it's essential to be selective when it comes to choosing assets.

"The unintended consequences of global quantitative easing are being felt across most asset markets. So being very selective has never been as important as today, given that a sound risk-reward relationship at current valuation levels is much harder to find. This includes real estate and infrastructure investing," says Toubia.

"We advocate for a targeted approach to real estate, one that has a strategy that is beyond a passive buy-and-hold perspective. The approach should include asset repositioning and a consideration of assets that benefit from ageing population trends."

As a newer opportunity, investors are not as familiar with alternatives as they are with the major asset classes. As such McNab says wealthy investors make two mistakes when they invest in alternatives.

"Investing in alternatives needs to be active. Over many years we have seen many high net worth investors seek to build alternatives into their portfolios by investing directly themselves in private market opportunities such as venture capital firms," he says. "This approach fails to recognise the specialist skill and effort required to manage alternative investments."

Another problem is that investors do not recognise the costs of liquidity. For instance, it tales longer to sell a commercial property than it does to sell a basket of shares.

"Many investors recognise the conceptual benefits of investing in alternatives but shy away from the illiquidity that alternatives typically entail," says McNab. "Investors need to recognise this search for liquidity comes with a significant cost. Returns from unlisted, illiquid alternative asset classes typically exceed those of liquid markets by significant amounts over the medium term, so by investing exclusively in illiquid assets they give up significant potential returns."

Hedge fund strategies

Investors must also keep in mind the very different risk/return characteristics of the different types of alternative investments. "Be clear about the type of alternative being considered and its role in the total portfolio allocation," says Tim Wedd, executive director of Crystal Wealth Partners.

"Often the expectation is that alternatives will automatically provide higher returns. This is often not the case. A more appropriate use is to consider hedge fund strategies for diversification purposes to reduce losses and concentration of equity market risk."

He says this is increasingly important in an environment where excess central bank liquidity continues to compress the natural risk/return trade-off profiles of the major assets classes.

"Targeting alternatives in this way is really trying to capture market inefficiencies, trends, valuations and periods of high volatility, to improve the overall return composition for a portfolio," Wedd says.

While alternatives have the potential to deliver higher returns to wealthy investor portfolios over time, they should not be viewed as a substitute for a diversified portfolio of a wide range of asset classes. It is also important that any allocation to alternatives fits with investors' long-term goals, taking into consideration the relatively illiquid nature of assets in this class.

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