Real Assets Review

Feature Article

A Three-Pronged Approach to Analyzing Real Assets

The appetite for alternatives has grown substantially over the years, both in assets under management and the scope of strategies offered. But the reasons investors turn to these strategies, in our view, is the same today as a generation ago: to seek asset class diversification, total-return potential and inflation protection. This Real Assets Review puts these criteria to the test, by assessing the long-term performance of a growing allocation to alternatives: listed real assets.

Real Asset Categories: 2014 Year-to-Date Highlights

Global Real Estate
Offices, Apartments, Shopping Centers, Regional Malls, Industrial, Self Storage, Health Care and Hotels

- After seeing solid gains in the first half of 2014, global real estate securities came under heavy selling pressure in September, but quickly recovered in October, as concerns over troubling economic trends in Europe and Asia were offset by expectations of additional policy easing.
- While the rest of the world has been slowing down, the U.S. economy has been picking up steam. Steady job gains and growing confidence have driven demand for all types of real estate in the U.S., resulting in strong gains for U.S. REITs.
- Globally, supply-and-demand trends remain generally favorable to landlords, offering attractive opportunities to invest in well-positioned companies trading at discounts to their underlying property values and/or their potential cash flows.

Commodities
Energy, Precious Metals, Base Metals and Agriculture

- After beginning 2014 on a positive note, commodity prices have fallen year to date across most subsectors amid a stronger dollar and sector-specific fundamentals.
- In the energy group, cuts in demand estimates and robust supply weighed on performance; U.S. crude oil production rose to its highest level in 28 years.
- The livestock sector was a standout. Feeder and live cattle prices generally improved on a continued tight supply outlook and strength in wholesale prices of beef.
- Gold and other high quality metals advanced initially, as geopolitical risks broadly supported prices. Those gains soon faded, however, in the face of U.S. dollar strength and the Federal Reserve’s well-telegraphed end of quantitative easing.

Global Natural Resource Equities
Energy, Metals & Mining and Agribusiness

- Natural resource stocks have been under pressure due to weakening economies in international developed markets and moderating fixed-asset and energy-consumption data in emerging markets. However, we are more optimistic in our outlook for the sector heading into 2015.
- While we remain cognizant of macro uncertainty within the energy and materials groups, we believe that recent volatility in these asset classes has introduced attractive opportunities.
- In our view, the elevated level of energy supply is not economically sustainable, and demand should react favorably to lowered prices.
- With regard to agribusiness, we believe that lower input costs should lead to a more constructive environment for producers.

Global Listed Infrastructure & MLPs
Utilities, Pipelines, Transportation and Communications

- The sector has outperformed broader markets year to date, spurred by the accelerating economic recovery in North America.
- Europe and Asia, whose recoveries have been more volatile, outperformed by a smaller margin. But as the year progressed, the sustainability of their recoveries came into question amid weakening economic news.
- After a third-quarter decline, solid earnings reports and a jump in U.S. gross domestic product reignited the sector in October.
- Midstream energy outpaced all other subsectors. Businesses with high growth potential, healthy fundamentals and forecasted distribution growth tended to have the best returns.
Weighing the Alternatives:
A Three-Pronged Approach to Analyzing Real Assets

There was a time when alternative investments were reserved for large scale investors with substantial sums of capital to invest, primarily in private market transactions. But today, investors have access to a far broader universe of asset classes and strategies, including registered funds structured with low minimum investments and ongoing liquidity. This marketplace may have changed over the years, but the reasons investors turn to real assets are the same today as a generation ago; they are seeking asset class diversification, enhanced return potential and positive sensitivity to inflation. We can use the same objective-based criteria to assess the merits of a real assets strategy.

1. Diversification Potential

Diversification potential is the ability to perform in periods when stocks and bonds are underperforming their long-term averages—which can be especially damaging to a portfolio’s long-term performance. As the chart below illustrates, real assets have performed well in these periods from May 1991 through September 2014, based on rolling one-year returns. In fact, each real asset category outperformed the 60/40 blended stock-bond allocation during these episodes, and the Diversified Real Assets Blend materially outperformed stocks and bonds, delivering an annualized average 12.1% total return.

Diversified liquid real assets have performed well when stocks and bonds have simultaneously underperformed their long-term averages.

For all charts on this spread: At September 30, 2014. Source: Bloomberg, Thomson Reuters Datastream and Cohen & Steers. Performance data quoted represents past performance. Past performance is no guarantee of future results. Stocks are represented by the S&P 500 Index. Bonds are represented by the BoFA Merrill Lynch U.S. 7–10 Year Treasury Index. The Diversified Real Assets Blend is represented by an equally weighted blend of Real Estate, Commodities, Natural Resource Equities and Infrastructure. Real Estate is represented by the FTSE NAREIT Equity REIT Index through February 2005 and the FTSE EPRA/NAREIT Developed Real Estate Index thereafter. Commodities are represented by the S&P GSCI through July 1998 and the Bloomberg Commodity Index, formerly known as the Dow Jones-UBS Commodity Index, thereafter. Natural Resource Equities are represented by a 50/50 Blend of the Datastream World Oil & Gas Index and Datastream World Basic Materials Index through May 2008 and the S&P Global Natural Resources Index thereafter. Infrastructure is represented by a 50/50 Blend of the Datastream World Pipelines Index and Datastream World Gas, Water & Multi-Utilities Index through July 2008 and the Dow Jones Brookfield Global Infrastructure Index thereafter. See the back cover for index definitions and additional disclosure.
The long-term returns of real assets have been on par with equities, but with less volatility, as measured by standard deviation.

2. Total-Return Potential

Over the long term, the investment returns of liquid real assets such as real estate, commodities, natural resource equities and global infrastructure have been attractive. But these individual categories tend to be volatile. Historically, however, a diversified mix of real assets has offered improved risk/return characteristics, with returns on par with equities and lower volatility, as measured by standard deviation.

### Exhibit 2: Diversifying Among Real Assets Has Historically Offered Attractive Annualized Returns Across Full-Market Cycles
May 1991–September 2014

<table>
<thead>
<tr>
<th></th>
<th>Stocks</th>
<th>Bonds</th>
<th>Real Estate</th>
<th>Commodities</th>
<th>Natural Resource Equities</th>
<th>Infrastructure</th>
<th>Diversified Real Assets Blend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annualized Return</td>
<td>9.4%</td>
<td>6.9%</td>
<td>10.6%</td>
<td>2.6%</td>
<td>8.8%</td>
<td>11.5%</td>
<td>8.8%</td>
</tr>
<tr>
<td>Volatility</td>
<td>14.6%</td>
<td>6.3%</td>
<td>17.0%</td>
<td>15.8%</td>
<td>17.7%</td>
<td>14.4%</td>
<td>13.2%</td>
</tr>
<tr>
<td>Sharpe Ratio</td>
<td>0.49</td>
<td>0.64</td>
<td>0.51</td>
<td>0.06</td>
<td>0.39</td>
<td>0.63</td>
<td>0.49</td>
</tr>
</tbody>
</table>

3. Positive Sensitivity to Changes in Inflation

History shows that the impact of inflation tends to be most damaging to a portfolio of stocks and bonds when it comes as a surprise. One potential benefit of real assets is that these categories tend to have higher, more positive sensitivities to these conditions than either stocks or bonds. In our view, if there is a single factor that unites real assets as an asset class, it lies in this potential to respond more positively when inflationary pressures accelerate. The chart below illustrates this point, by measuring the relative sensitivity of various asset classes in periods when realized inflation was higher than its year-earlier forecast.\(^1\) Our key takeaway from this analysis is the potential for real assets to outperform in periods when inflation surprises are likely to more negatively impact traditional stock/bond allocations.

### Exhibit 3: Asset Class Sensitivity to Periods of Unexpected Inflation
May 1991–September 2014

<table>
<thead>
<tr>
<th></th>
<th>Bonds</th>
<th>Stocks</th>
<th>Diversified Real Assets Blend</th>
<th>Real Estate</th>
<th>Infrastructure</th>
<th>Natural Resource Equities</th>
<th>Commodities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation Beta</td>
<td>-0.7</td>
<td>-0.7</td>
<td>5.1</td>
<td>1.5</td>
<td>4.8</td>
<td>5.5</td>
<td>8.1</td>
</tr>
</tbody>
</table>

\(^1\) Inflation sensitivity was determined by calculating the linear regression beta of 1-year real returns to the difference between the year-over-year realized inflation rate and lagged 1-year ahead expected inflation, including the level of the lagged expected inflation rate. Linear regression is a statistical method that models the relationship between a dependent variable and one or more explanatory variables.
Behind the Numbers
A Growing Allocation to Alternatives

The listed real assets marketplace provides liquid strategies that can help achieve three common investor objectives: to enhance the asset-class diversification, total-return potential and inflation protection of their portfolios. In our view, this diversification is best achieved through actively managed strategies, which, in recent years, have grown significant in size and scope. For diversified liquid real asset strategies and their key components—REITs, commodities, natural resource equities and global infrastructure—the table below summarizes this growth since the financial crisis. REITs remain the largest category, although the highest growth rate has been witnessed by infrastructure, particularly in the North American energy sector. The past five years have also given rise to diversified, actively managed real asset strategies.

<table>
<thead>
<tr>
<th>Percent of institutions allocated to real assets in 2013</th>
<th>Percent of financial advisors who allocated client assets to real assets in 2013</th>
<th>Percent of financial advisors and institutions who see diversification as the #1 reason to use real assets</th>
<th>The five-year growth rate of diversified real asset strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td>97%</td>
<td>90%</td>
<td>70%</td>
<td>372%</td>
</tr>
</tbody>
</table>

Source: Greenwich Associates, Evestment, Fuse Research and Cohen & Steers. (a) Based on a January 2014 survey of 667 financial advisors conducted for Cohen & Steers by Fuse Research. (b) Based on the Fuse Research survey noted above and an October 2014 survey of 110 institutions conducted by Greenwich Associates.

Index Definitions

An investor cannot invest directly in an index, and index performance does not reflect the deduction of any fees, expenses or taxes.

The Bloomberg Commodity Index is a broadly diversified index composed of commodities traded on U.S. exchanges, with the exception of aluminum, nickel and zinc, which trade on the London Metals Exchange. The BoA Merrill Lynch U.S. 7–10 Year Treasury Index is composed of U.S. Treasury Notes with a 7–10 year maturity. The Dow Jones Brookfield Global Infrastructure Index measures the stock performance of publicly listed infrastructure companies. The index intends to measure all sectors of the infrastructure market. The FTSE NAREIT Equity REIT Index is an unmanaged, market-capitalization-weighted index of all publicly traded U.S. REITs that invest predominantly in the equity ownership of real estate, not including timber and infrastructure. The FTSE EPRA/NAREIT Developed Real Estate Index (net) is an unmanaged market-weighted total return index which consists of many companies from developed markets who derive more than half of their revenue from property-related activities. The S&P 500 Index is an unmanaged index of 500 large-capitalization, publicly traded stocks representing a variety of industries.

Performance data quoted represents past performance. Past performance is no guarantee of future results. The views and opinions in the preceding commentary are as of the date of publication and are subject to change without notice. This material represents an assessment of the market environment at a specific point in time, should not be relied upon as investment advice, is not intended to predict or depict performance of any investment and does not constitute a recommendation or an offer for a particular security. We consider the information in this presentation to be accurate, but we do not represent that it is complete or should be relied upon as the sole source of suitability for investment. There is no guarantee that any historical trend illustrated in this commentary will be repeated in the future, and there is no way to predict precisely when such a trend will begin. There is no guarantee that a market forecast made in this commentary will be realized.

Understanding the Risks of Investing. A real assets strategy is subject to the risk that its asset allocations may not achieve the desired risk-return characteristic, underperform other similar investment strategies or cause an investor to lose money. The risks of investing in REITs are similar to those associated with direct investments in real estate securities. Property values may fall due to increasing vacancies, declining rents resulting from economic, legal, tax, political or technological developments, lack of liquidity, limited diversification and sensitivity to certain economic factors such as interest rate changes and market recessions. An investment in commodity-linked derivative instruments may be subject to greater volatility than investments in traditional securities, particularly if the instruments involve leverage. The value of commodity-linked derivative instruments may be affected by changes in overall market movements, commodity index volatility, changes in interest rates, or factors affecting a particular industry or commodity, such as drought, floods, weather, livestock disease, embargoes, tariffs and international economic, political and regulatory developments. The use of derivatives presents risks different from and, possibly greater than, the risks associated with investing directly in traditional securities. Among the risks presented are market risk, credit risk, counterparty risk, leverage risk and liquidity risk. The use of derivatives can lead to losses because of adverse movements in the price or value of the underlying asset, index or rate, which may be magnified by certain features of the derivatives. Infrastructure issuers may be subject to adverse economic occurrences, government regulation, operational or other mishaps, tariffs and changes in tax laws and accounting standards. Foreign securities involve special risks, including currency fluctuation and lower liquidity. The market value of securities of natural resource companies may be affected by numerous factors, including events occurring in nature, inflationary pressures and international politics. Because the strategy invests significantly in natural resource companies, there is the risk that the strategy will perform poorly during a downturn in the natural resource sector.

Futures Trading Is Volatile, Highly Leveraged and May Be Illiquid. Investments in commodity futures contracts and options on commodity futures contracts have a high degree of price variability and are subject to rapid and substantial price changes. Such investments could incur significant losses. There can be no assurance that the options strategy will be successful. The use of options on commodity futures contracts is to enhance risk-adjusted total returns. The use of options, however, may not provide any, or only partial, protection for market declines. The return performance of the commodity futures contracts may not parallel the performance of the commodities or indexes that serve as the basis for the options it buys or sells; this basis risk may reduce overall returns.

This commentary must be accompanied by the most recent Cohen & Steers Real Assets Fund fact sheet if used in connection with the sale of mutual fund shares.

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