PERSONAL WEALTH ADVISORY BY
Laird Norton Wetherby

Why We Invest in Real Assets

A key focus at LNW is optimal diversification within client portfolios to benefit from the unique attributes of each asset class. Toward that, we typically include allocations to real assets along with financial assets such as equities and bonds. Below, we discuss why and how we include real assets in LNW portfolios.

Let's start by defining real assets. Real assets tend to have physical attributes, and their value is derived from their production, consumption or ownership. At LNW, we group real assets into four major categories: real estate, infrastructure, commodities and natural resources.

We invest in real assets through various access vehicles in both the public and private markets. Investment can be direct, through the ownership of shares in companies that own real assets, or through financial instruments tied to the trading of real assets (for example, commodity futures).

We believe real assets can be used strategically to improve portfolio outcomes. During periods of higher inflation and market volatility, the value of real assets lies in their inherent physical attributes, be it an apartment building or a bar of gold. The multiple benefits of an allocation to real assets include:

- **Inflation sensitivity:** Many types of real assets increase in market value and/or their earnings rise (either contractually or through regulatory allowances) as inflation increases.
- **Portfolio diversification:** Real assets can enhance portfolio diversification across sectors, industries, countries and especially against financial assets such as equities and bonds. Take a look at the correlation matrix below. For the 10 years ended March 2024, the returns of most real assets had relatively low correlation to major stock and bond indices. Among real assets, publicly traded infrastructure and REITs (Real Estate Investment Trusts) had the highest correlation to the U.S. stock market (0.77 or higher).

Correlation Matrix: US Stocks & Bonds Vs. Various Types of Real Assets (2014-2024)

Scale of 0 to 1: 0 = no correlation; 1 = perfect correlation

Asset	US Stocks	US Bonds	Commo-dities	Agri-culture	Precious Metals	Energy Stocks	REITs	Global Infra-structure	Inflation Linked Bonds	MLP's	Natural Resources	Private Energy	Private Agri-culture	Private Mining	Private Timber	Private Infra-structure	Private Real Estate
US Stocks																	
US Bonds	0.33																
Commodities	0.40	-0.29															
Agriculture	0.22	-0.20	0.65														
Precious Metals	0.29	0.59	0.23	0.26													
Energy Stocks	0.55	-0.30	0.76	0.35	0.10												
REITs	0.82	0.46	0.36	0.22	0.35	0.52											
Global Infrastructure	0.77	0.30	0.57	0.33	0.48	0.68	0.85										
Inflation Linked Bonds	0.64	0.79	0.17	0.15	0.69	0.11	0.68	0.63									
MLP's	0.67	-0.10	0.65	0.27	0.15	0.89	0.60	0.72	0.21								
Natural Resources	0.65	-0.17	0.79	0.35	0.23	0.98	0.59	0.75	0.25	0.90							
Private Energy	0.48	-0.34	0.78	0.35	0.00	0.82	0.47	0.61	0.07	0.80	0.82						
Private Agriculture	0.11	-0.18	0.50	0.41	0.23	0.41	0.21	0.32	-0.01	0.31	0.41	0.41					
Private Mining	0.51	0.09	0.46	0.23	0.20	0.41	0.49	0.53	0.39	0.44	0.49	0.62	0.16				
Private Timber	0.33	0.13	0.23	0.16	0.25	0.41	0.42	0.51	0.24	0.40	0.40	0.32	0.32	0.24			
Private Infrastructure	0.54	0.06	0.42	0.34	0.09	0.41	0.62	0.66	0.40	0.42	0.44	0.55	0.27	0.50	0.47		
Private Real Estate	0.37	-0.15	0.47	0.46	-0.02	0.37	0.51	0.48	0.22	0.29	0.38	0.51	0.24	0.34	0.12	0.70	

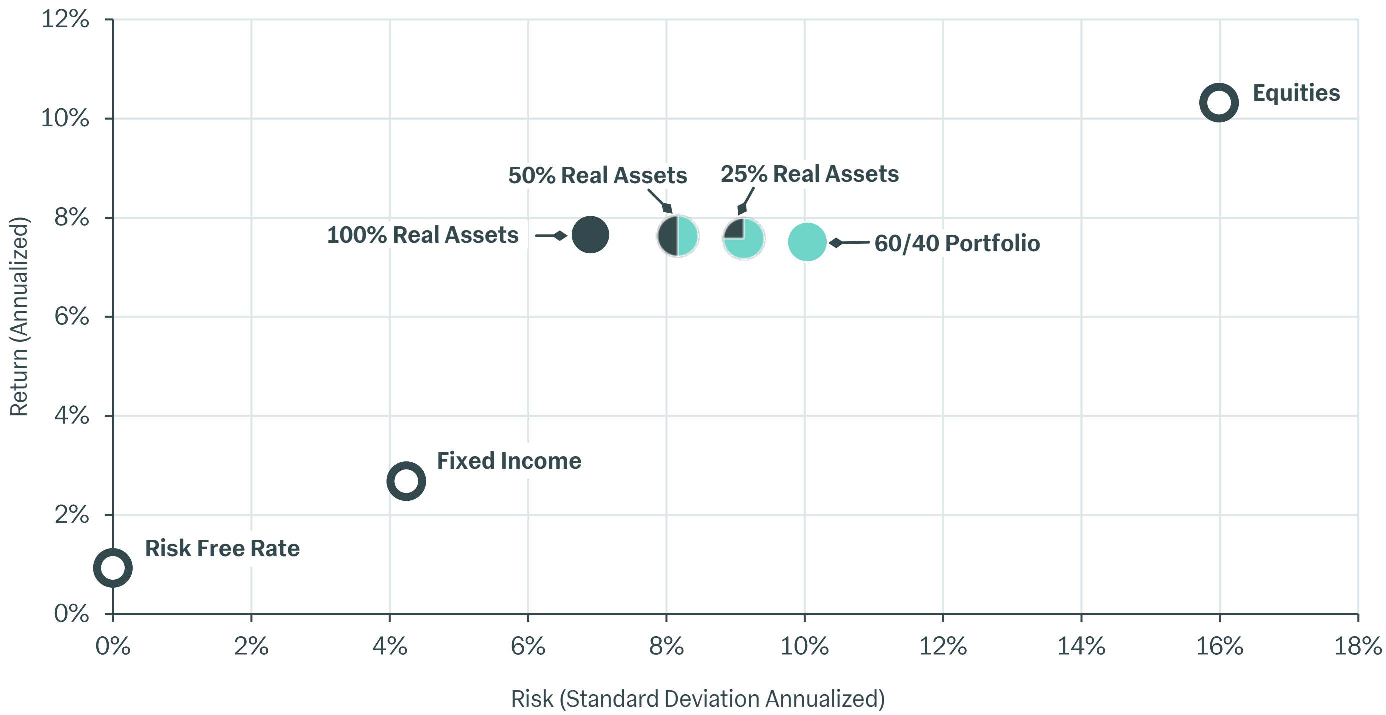
From March 31st 2014 - March 31st 2024. Data in US dollars. US Stocks = Russell 1000 Index; US Bonds = Bloomberg US Aggregate Bond Index; Commodities = Bloomberg Commodity Index; Agriculture = S&P GSCI Agriculture Index; Precious Metals = S&P GSCI Precious Metals Index; Energy Stocks = S&P Energy Select Sector Index; REITs = S&P Global REIT Index; Global Infrastructure = S&P Global Infrastructure Index; Inflation Linked Bonds = Bloomberg Global Inflation Linked Bonds Index; MLP's = Alerian MLP Index; Natural Resources = S&P North American Natural Resources Index; Private Energy = Cobalt LP Natural Resources - Energy Index; Private Agriculture = Cobalt LP Natural Resources - Agriculture Index; Private Mining = Cobalt LP Natural Resources - Mining Index; Private Timber = Cobalt LP Natural Resources -Timber Index; Private Infrastructure = Cobalt LP Infrastructure Index; Private Real Estate = Cobalt LP Real Estate Index

Source of Data: Cobalt LP, Morningstar.

- **Additional source of income:** Some real assets – including infrastructure, real estate and energy production – can pay relatively high dividends, providing an additional source of income outside of bonds and dividend-paying stocks.
- **Potential for higher risk-adjusted returns:** The relatively low correlations in pricing between real assets and traditional stocks and bonds can potentially lower portfolio risk and enhance risk-adjusted returns over a full market cycle.

The chart below shows the risk and return of various combinations of assets over the last 15 years. It illustrates that, historically, adding a mix of public and private real assets to a 60/40 portfolio improved its risk-adjusted return by providing a similar return with lower volatility.

Adding Real Assets to a Traditional 60% Equity/40% Fixed Income Portfolio May Reduce Volatility



Source: Morningstar, Cobalt LP, LNW. For the period January 1, 2009, through December 31, 2023. Equities reflect the MSCI All Country World Investable Market Index. Fixed Income reflects Bloomberg US Aggregate Bond Index. A 60/40 Portfolio reflects a blend of 60% Equities and 40% Fixed Income. Real Assets reflects a custom blend consisting of 50% S&P Real Assets Index, 25% Cobalt LP Private Infrastructure Index and 25% Cobalt LP Private Real Estate Index.

When/How We Invest in Real Assets

The rationale for LNW's investment in real assets is embedded in our investment philosophy. Real assets play an important role in the multiple "levers" we use to achieve client goals. Whether it is the inflation protection lever, the income/yield lever, the positive impact lever or the private markets lever, real assets can help control the range of possible portfolio outcomes.

We access real assets through public and private vehicles on our client's behalf. We believe each of the four major asset categories in this space can play an important role in helping achieve client goals.

The following is a closer look at the merits and concerns we see for each type of real asset.

Closer Look

Infrastructure

Infrastructure comprises a variety of investments that share many of these characteristics:

- Essential or necessary product or service
- Long useful life
- Monopoly/quasi-monopoly market position
- Operates in regulated environments and/or is less affected by economic cycles
- Lower variation in annual cash flow and earnings
- Difficult to impose price decreases given high-fixed asset costs and/or scarcity of resources (i.e. land, planning restrictions)

Infrastructure companies are typically found in the following sectors:

Energy	Water	Transport	Comms	Social
• Power generation • Transmission • Distribution • Renewables	• Water and Wastewater Networks • Desalination Plants	• Ports • Rail • Airports • Roads • Bridges • Parking	• Cable Networks • Telecom Lines • Towers • Satellites	• Hospitals • Prisons • Schools • Courts • Public Housing

Benefits

- **Growth Opportunity:** Most of the $49 trillion estimated in global infrastructure spending over the next decade will likely come from private markets, since governments with already stretched budgets will not have sufficient resources for massive new investment. Most of these investments will be for essential services (i.e. electricity, roads, telecom, water) and therefore not as dependent on economic cycles.
- **Additional Income:** Some infrastructure investments provide an additional source of income for portfolios as those assets are leased based on long-term contracts and generate a stream of cash flows.
- **Portfolio Diversification and Downside Protection:** The pricing of infrastructure assets has historically had relatively low correlation to stocks, bonds and real estate. Infrastructure assets tend to provide services, often essential, for which demand is relatively constant (utilities, cell phone towers, toll roads), resulting in relatively stable earnings streams and cushioning them from downside volatility.

Risks

- **Political/Regulatory:** Investments in infrastructure can be hurt by tax and regulatory policy changes. Infrastructure assets can be nationalized, or taken over by the government, obliterating their market value. Additionally, returns can be dampened by onerous new regulations, including a lower cap on rate increases, which can negatively impact what the asset earns over time.

- **Economic Sensitivity:** Certain types of infrastructure, including toll roads and other types of transit, have attractive risk/reward characteristics, but they may not be inherently essential services and could be vulnerable to downturns in the economy.
- **Lack of Technical/Political Know-How:** Owners and managers must be highly skilled in operating infrastructure projects, which tend to be complex and large in scope. Further, management must also be able to work successfully with regulators and local governments.

Real Estate

Real estate comprises a variety of property types accessible to investors either directly (through the purchase of a building) or through a public or private fund structure, which tends to be more diversified than a direct investment. The major categories of commercial real estate used for business-related purposes include multifamily, industrial, office, retail and other (hospitality, self-storage, etc.).

Apartments/ Multifamily	Industrials	Office	Retail	Other
• Residential • Affordable Housing • Senior Housing • Student Housing	• Warehouse/ Distribution Centers • Data Centers • Flexible R&D Facilities	• General Use • Life Sciences • Medical Offices	• Malls • Neighborhood Shopping Centers • Specialized Retail Centers	• Hotels • Self-Storage • Single-Family Rentals • Parking • Land

Benefits

- **Attractive Yield:** Historically, a significant portion of the return investors have earned from real estate has come from income generated by the properties.
- **Defensive:** Depending on the strategy, certain property types have long-term leases, meaning they can ride out a certain amount of economic stress. While profits would be hurt in a recession, certain property types are somewhat buffered by the fact that there are penalties for breaking leases and most people and companies prefer staying put during times of economic turmoil.
- **Inflation Sensitivity:** During times of rising prices, both rents and property values tend to increase.

Risks

- **Interest Rate Risk:** Real estate, as with other risk assets, tends to be highly sensitive to changes in interest rates for three key reasons: 1) The cash flow a property generates plays a big role in its valuation, and higher interest rates mean the cash flow is not worth as much over time (a higher discount rates is applied) resulting in lower valuations for the property; 2) Real estate projects tend to carry significant levels of debt, which becomes more expensive to service or issue as rates rise, negatively impacting valuations; and 3) rising interest rates make the locked-in yields from rents and leases less attractive.
- **Supply/Demand Risk:** Given a strong U.S. economy, the building of new apartment buildings and office complexes has increased dramatically. An economic slowdown could lead to reduced pricing and rent concessions in oversupplied markets.
- **Higher Correlation to Equities:** Publicly traded real estate trusts (REITs) generally have a higher correlation to equities, in that they are likely to underperform when the economy is weak (and vice versa).

Commodities

Commodities are any raw material or agricultural product that can be traded globally, usually at a set price, often in U.S. dollars. They're usually grouped into six main categories:

Energy	Base Metals	Precious Metals	Agricultural	Softs	Livestock
• Oil	• Aluminum	• Gold	• Corn	• Cocoa	• Cattle
• Natural Gas	• Copper	• Silver	• Soybeans	• Coffee	• Hogs
• Byproducts	• Lead		• Soybean Meal	• Cotton	
	• Nickel		• Soybean Oil	• Sugar	
	• Zinc		• Wheat		

Benefits

- **Inflation Sensitivity:** As measures of inflation rise, commodity prices tend to as well.
- **Diversifier:** Commodities have historically had relatively low correlations with other asset classes and even among each other.
- **Value Additive:** Demand for commodities will likely trend with global population and economic growth which we believe will be a positive for commodity prices over the long run.

Risks

- **Supply/Demand:** Commodities tend to perform poorly when global supply is expected to outstrip demand, as when there is a regional or global economic downturn, or there is overproduction. Low economic growth expectations for China, for example, can impact a variety of commodity prices as China is a large global importer of commodities.
- **Price Volatility:** Commodity price swings can be severe, as traders price in new information almost immediately.
- **Political and Economic Risk:** Commodity prices are exposed to global political and economic risks, including currency fluctuations. A stronger dollar, for example, tends to reduce demand for commodities traded in dollars. Other events that could significantly impact prices include tariffs and other types of import controls, cartel pricing such as that by OPEC, and government regulations.

Natural Resources

Investment in natural resources is usually through companies that hold, collect and/or refine specific resources – from trees to lithium to gold. Unlike commodities, with which there is great overlap, the market value of natural resources is less standardized and can vary depending on how the resource is processed and marketed.

Energy	Metals & Minerals	Agriculture	Water	Forestry
• Oil Companies	• Precious Metals	• Farming	• Supply	• Timberland
• Natural Gas Distributors	• Industrial Metals	• Livestock	• Purification	• Forestry Management
• Mining Corporations	• Rare Earth Elements	• Agricultural Commodities	• Sanitation	• Paper & Pulp Mills
• Renewables Producers			• Distribution	• Carbon Capture

Benefits

- **Inflation Sensitivity:** As with commodities, natural resource prices benefit from rising inflation and rising demand due to global growth. Natural resources can also act as a store of value and become more valuable as inflation eats into investor returns in other asset classes.
- **Growing Demand:** As the global populations and economies grow, demand for critical natural resources such as energy, food and minerals tends to increase, which can support long-term investment returns.

Risks

- **Price Volatility:** The risks are also similar to those of commodities. However, the valuations of natural resource companies depend not just on the market price of the resource being processed, but also on the ability of management to operate profitably by leveraging new technology and entering new markets.
- **Regulatory & Environmental Risks:** Regulations and restrictions (certain types of taxes/tariffs and environmental laws) can impact the profitability of natural resource companies.
- **Currency Risk:** Many natural resources are traded globally in U.S. dollars. Fluctuations in the exchange rate can impact profitability.

Takeaways

At LNW, we view real assets as building blocks toward achieving the targeted risk and return necessary for client goal achievement. The asset class has "levers" that can accomplish multiple objectives: inflation sensitivity, portfolio diversification, source of additional income and return for portfolios. That said, investing in real assets involves a broad array of vehicles (both public and private), any of which can move quickly in and out of favor with investors.

Consequently, we have found that the optimal way to invest in real assets is to avoid concentration in one type of real asset, avoid market timing, and complement core positions with select opportunities in real estate, infrastructure or commodities/natural resources that on a strategic basis position us to deliver on the specific objectives sought by clients.

If you have questions or want to learn more about our approach to real assets, please reach out to your LNW wealth manager. Not a client? Please contact us at hello@lnwadvisors.com or (800) 475-9159.

ABOUT THE AUTHORS

The LNW investment team is comprised of 12 analysts and strategists working together to design and implement investment solutions for client portfolios. Six analysts at the firm hold the Chartered Financial Analyst® designation, with expertise spanning macroeconomics, public and private asset classes across the global capital markets, and impact investing. Collaborating with each other and with client advisors, the investment team's overarching goal is to help clients and their families preserve and grow their wealth over many generations.

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