

Real Assets in Emerging and Frontier Markets

Stockholm (HedgeNordic) – The long-lasting low interest rate environment has been forcing institutional investors such as pension funds, insurers and others to turn to real assets to achieve their goals. **Aki Kostander** (*pictured*), CIO and Head of Real Assets at **UB Asset Management**, reckons that real assets as an asset class “has become a substitute to fixed income investing” as investors find it “very difficult to locate attractive risk-return opportunities in that space.”

While acknowledging that “real assets can be tricky sometimes,” Kostander points out that the main advantages of this asset class include “inflation-adjusted cash flows and a real asset underneath with a positive residual value regardless of what happens to the economy, quantitative easing and interest rates.” According to UB Asset Management’s Head of Real Assets, investors can get “a decent real return on most real asset investments today, so one should feel comfortable with these investments especially if it’s done without excessive leverage.”

Infrastructure, Real Estate, and Emerging Markets: Perfect Combo

UB EM Frontier Real Assets is one vehicle that stands out from UB Asset Management’s wide range of funds. As Kostander explains, this fund maintains a “portfolio of companies which are investing in and operating urban infrastructure and real estate in emerging and frontier markets.” Specifically, UB EM Frontier Real Assets seeks to invest in stable, cash flow-generating companies across fast-growing emerging and frontier markets. “This is a vehicle for tapping in the long-term megatrend of urbanization,” emphasizes Kostander.

Explaining the geographical focus of UB EM Frontier Real Assets, Kostander says that “the urbanization trend is strongest within frontier and emerging markets.” The rising population in urban areas “almost guarantees a higher demand for properties and infrastructure,” he argues. “People will need more housing, electricity and sanitation, places to work and shop, higher capacity for logistics within cities and between cities, as well as more seaports and airports.” However, “this does not guarantee superior returns for the end investor,” warns Kostander, and continues, “but it definitely aligns the external factors for the management of these companies to succeed.”

Infrastructure and Real Estate: 50/50

The investment strategy behind UB EM Frontier Real Assets sits on two legs – infrastructure and real estate, with the fund typically allocating equally between the two legs. The infrastructure leg includes companies “with a monopolistic status in their markets”, focusing on power and electricity, water and sanitation, transport such as rail, airports and ports. The real estate leg, meanwhile, includes companies with “REIT-style” operations, with the UB team “favoring companies which are long term holders and operators of properties.”

Companies in both legs “derive their revenues from an immovable and tangible asset base,” explains Kostander, who adds that these companies “are shielded to a large extent from international competition and can be considered as pure local businesses servicing local societies.” Infrastructure and real estate tend to complement each other and help build a well-diversified portfolio. “Real estate is probably a bit more cyclical,” says Kostander, but “infrastructure companies mitigate the risk.” Even so, “infrastructure companies are often operating in a regulated environment and are thus exposed to political decisions and environments,” acknowledges Kostander.

Track Record: So Far, So Good

Kostiander explains that UB EM Frontier Real Assets makes equity investments with equity-like risk, so investors should expect equity-like returns. The UB team would be happy to generate a similar level of returns as the MSCI Emerging Markets Index, but “we should be able to provide this level of returns with a lower risk profile,” argues Kostiander. After all, real estate and especially infrastructure often act as low-volatility vehicles. UB EM Frontier Real Assets has not disappointed so far.

Launched in May of last year, UB EM Frontier Real Assets returned a cumulative 8.9 percent since inception through the end of September after gaining 11.8 percent year-to-date. Although the fund is relatively young, “the start has been fairly strong,” says Kostiander. “The fund is running at over 10 percent while the MSCI Emerging Markets Index is running flattish, and the volatility in the fund’s returns has been 2-3 percentage points lower compared to the MSCI.” Because the fund is based on such a strong theme involving the fast-increasing urbanization in emerging and frontier markets, UB EM Frontier Real Assets is “not really dependent on any market condition and acts as an all-weather portfolio,” concludes Kostiander.

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