Brookfield's Antonatos: Real Assets Offer Diversification, Balance In Tough Times

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Chuck Jaffe, in The NAVigator podcast, interviewed Larry Antonatos, managing director/portfolio manager at Brookfield Asset Management. Read the Q & A below as Zach says 'the depths of uncertainty and the market lows surrounding coronavirus are behind us.' The manager of Brookfield Real Assets Income Fund said the firm's real asset managers are positioning now for a recover – which he noted may not be particularly strong – by focusing on areas where valuations are most attractive and recovery-driven cashflow growth should be strongest. That means hotels, retail, real estate, airports and more.

Larry Antonatos

The podcast can be found on AICA's website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

CHUCK JAFFE: Larry Antonatos, portfolio manager at Brookfield Asset Management is here, and we're talking real assets now on The NAVigator. This is The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by The Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry, from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. Joining me today to point us in the direction of real assets, it's Larry Antonatos, portfolio manager at the Brookfield Real Asset Income Fund, that's a closed-end fund. He's also manager of the Brookfield Real Assets Securities Fund, that is a traditional mutual fund. He's part of the Real Assets Solutions team for Brookfield's public securities group. Learn more about the funds, the firm, and Larry at Brookfield.com. You can learn more about closed-end fund investing at AICAlliance.org, the website for the Active Investment Company Alliance. Larry Antonatos, thank you for joining me.

LARRY ANTONATOS: Happy to be here Chuck. Thanks for having me.

CHUCK JAFFE: Let's start with the basics. Please define real assets for us, and tell us how investors benefit from adding real assets to their portfolio.

LARRY ANTONATOS: Sure. Real assets are investible assets that are physical in nature, rather than financial or intellectual. The three major types of real assets are real estate, infrastructure, and natural resources. Let's take real estate first. It is the most well understood and most widely held of the real assets. Real estate value is generally derived from rental income based on lease agreements. Real estate is a free market, competitive industry, with many landlords and many tenants. Like most competitive industries, supply and demand determines price. In this case, the price is the rental rate. Supply is driven by cycles of new construction. You can see that with cranes on the horizon. And demand is driven by cycles of economic activity. These cycles can cause market rental rates to move up and down. However, I want to emphasize that property cashflows and property values tend to be much steadier than market rental rates due to the long-term nature of real-estate leases. Most commercial property is governed by leases of five years to ten years.

CHUCK JAFFE: Let me step in before you move any further. Has the real estate market and the real asset value changed dramatically as a result of what we've seen with COVID-19?

LARRY ANTONATOS: COVID-19 has had some effects within the real estate space that's created some winners and some losers. Let's take some losers first since that's what you asked about. The obvious number one loser is the hotel sector. Many hotels have been closed, and for those that have been open, the occupancy rates are very, very low. I want to emphasize that hotels are a real estate type that has a one night lease. As opposed to most commercial real estate is five year or ten year leases, as I mentioned a moment ago. Those one night leases can be very volatile. You don’t know how many rooms you're going to rent, and you actually don't know what price you're going to get for those rooms. So that's been the biggest loser because people have stopped travelling. At some point, that reverses, people will start travelling again. Hotels will open up again, hotel occupancies will improve. Will we ever get back to w here we were six month ago? Remains to be seen, but that's definitely on the losing end of the spectrum. The winning end of the spectrum is data centers. This is where the backbone of the internet lives. They look like industrial buildings, warehouse buildings, but they're full of data servers, highly air conditioned, tremendous amounts of power coming to those buildings. We are all working from home and relying on internet connectivity to get our jobs done, and that has been a dramatic winner in the real estate space since COVID-19 started.

CHUCK JAFFE: Now I'll let you get back to your original explanation of real assets, because we had three different types. Let's move to the second.

LARRY ANTONATOS: Sure. The second type is infrastructure, and infrastructure is a terrific compliment to real estate, and we see the level of interest in infrastructure growing very rapidly. Infrastructure value is generally derived from fees charged to provide infrastructure services. This is things like energy, communications, transportation. Infrastructure has interesting characteristics of supply, demand, and pricing that are very different from those of real estate. The supply of infrastructure assets is frequently regulated, and many infrastructure assets are monopolies or semi-monopolies. Such as the only electric utility or only water utility or only airport serving a city or geographic area. And it's great to be in a monopoly position. Infrastructure services has a demand that is generally steady because these services are generally essential; power, water, communication. A fourth area of infrastructure, transportation, which includes airports, sea ports, and toll roads, is subject to traffic fluctuations and economic sensitivity. And as we just talked about in hotels, airports are one of the most impacted sectors within infrastructure because people have stopped travelling. Now the pricing for infrastructure services is not governed by the intersection of supply and demand like it generally is in real estate, which is a competitive business. In fact, much of the infrastructure space is regulated. The government allows you to have a monopoly or a semi-monopoly, but in return they will regulate your prices because you are providing essential services. Because of these special supply, demand, and pricing characteristics, infrastructure can provide very predictable cashflows and values.

CHUCK JAFFE: That's infrastructure. And the third leg of the triangle?

LARRY ANTONATOS: The third type of real assets is natural resources. Natural resources value is generally derived from the spot prices of commodities, including agriculture, energy, metals, and mining commodities. Supply of these commodities is generally increasing due to technological improvements over time. Demand is generally cyclical based on economic activity. Accordingly, cashflows and values for natural resources can be much more volatile than you see in real estate and infrastructure.

CHUCK JAFFE: How have real assets been performing during this viral economy time? And how well have they diversified a portfolio for investors who have gone that way?

LARRY ANTONATOS: Well Chuck, real assets generally provide four important investment benefits. So let me give you that background, then we'll talk about how they performed more recently. The four investment benefits that real assets offer are current income, long-term capital appreciation, inflation protection, and from a total portfolio perspective, diversification relative to traditional equities in fixed-income. By that, I mean they tend to behave differently than traditional equities in fixed-income. Now real estate and infrastructure in particular can provide these investment benefits through market cycles and in many different market environments because real estate and infrastructure cashflows offer a combination of downside protection as well as upside participation. Now since COVID-19 hit, we would have expected infrastructure to be the better performer within the real asset space. Infrastructure has the steadiest cashflows, real estate would be in the middle, and natural resources would be at the bottom with the most volatile cashflows. And that's exactly what we found. In the early days of the market drawdown, real assets actually outperformed the broad equity market. But as the drawdown accelerated in March, real assets sort of caught up. And in particular, infrastructure ended Q1 performing absolutely in line with the broad market. Real estate underperformed, and natural resources underperformed even more, particularly energy. Energy was very weak due to a global slowdown driving a global reduction in demand for oil.

CHUCK JAFFE: What do you see going forward for the rest of this year and into 2021?

LARRY ANTONATOS: Looking ahead from a macroeconomic perspective, we expect economic growth, interest rates, and inflation will all remain low for quite some time. In this environment, we expect real assets to perform well relative to traditional equities in fixed-income due to the high current income and the defensive growth profile of real assets. Now our portfolios were defensive in 2020 Q1, we favored fixed-income over equities and we favored infrastructure over real estate. In 2020 Q2, we have been reversing that positioning, we've been adding to equities, particularly real estate equities. We believe the depths of uncertainty and the market lows surrounding coronavirus are behind us. We are positioning for a recovery. It may not be strong, it may not be rapid, but it will be a recovery. It may be two steps forward, one step back. And we are focused on adding sectors and securities where valuations are the most attractive, and where the recovery-driven cashflow growth will be the strongest. This involves prudent allocation to out of favor sectors that I mentioned earlier within real estate, hotels, and also to retail. Many shopping centers have been closed, they're just now opening up. And within infrastructure, we're looking for opportunities within airports and within energy infrastructure.

CHUCK JAFFE: Larry, great stuff. Thank you so much for joining me to talk about it.

LARRY ANTONATOS: Happy to be here Chuck. Thank you.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I'm Chuck Jaffe, check out my show on your favorite podcast app or at MoneyLifeShow.com. To learn more about closed-end funds and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance, on Facebook and LinkedIn @AICAlliance. Thanks to my guest, Larry Antonatos, managing director at Brookfield Asset Management, portfolio manager for the Brookfield Real Assets Income Fund. Get more information at Brookfield.com. The NAVigator podcast is available every Friday, please subscribe on your favorite podcast app and join us again next week for more closed-end fun. Until then, stay safe everybody.

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