Bright outlook for real assets: Brookfield

Attractive returns seen for assets such as infrastructure and real estate.

Wednesday, March 29, 2017 - 05:50

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THE BUSINESS TIMES

"We continue to think rates globally will be low for at least this cycle. Europe, Japan, the UK will all be even lower than the US. As a result all the real asset products and investments we make can still earn a very good return on capital," said Brookfield chief executive Bruce Flatt. PHOTO: KELVIN CHNG

REAL assets such as infrastructure and real estate are expected to continue to generate attractive returns, even as interest rates creep upwards.

Bruce Flatt, chief executive of Brookfield Asset Management, believes interest rates will stay relatively low - a good backdrop for real assets.

"We continue to think rates globally will be low for at least this cycle. Europe, Japan, the UK will all be even lower than the US. As a result all the real asset products and investments we make can still earn a very good return on capital.

"Real asset investments can earn outsized returns for the risk one takes, given that we've been doing this a long time and we're very global in nature."

Brookfield, one of the world's leading real asset investors, was founded more than a century ago. It has some US$250 billion under management, of which about 62 per cent or US$155 billion is in real estate.

Renewable power and infrastructure have a share of about 32 per cent each, and private equity accounts for eight per cent.

Inflows have also been strong, as private investors have increasingly embraced real assets despite their illiquidity. Brookfield's investors are mainly large institutions and sovereign wealth funds.

In 2016, for instance, it raised some US$30 billion in capital for private strategies. Of this, US$14 billion went into infrastructure and US$9 billion into real estate.

It has US$110 billion in fee-bearing capital which generates some US$2 billion in annualised fees. This capital comprises listed partnerships, private funds and public securities.

Mr Flatt said client portfolio allocations into real assets stand at around 10 per cent on average today, although some clients have invested more than 50 per cent.

"We think if we continue in the environment we're in, those allocations will at least on average double to 20 per cent. You'll see some clients go closer to the 50 per cent level."

The firm aims to generate 12 to 15 per cent compound returns over the long term.

So far it has achieved that - in 2016 based on its stock performance including dividends, it returned 26 per cent. This is on par with the S&P500.

Over 20 years, it generated 17 per cent on an annualised basis, compared to 7 per cent by the S&P500 and 5 per cent by 10-year Treasuries.

The firm pursues a value strategy, ferreting out "attractively priced" assets in areas where there may be a dearth of capital. Its managers seek to enhance the asset, improve cash flows and make operational improvements.

"We globalised the business for one simple reason - we wanted to ensure we could move money that we have in global mandates to countries and assets which were attractively priced. In 2009, the best place globally to put money was in the US, based on the opportunity set and the lack of available capital. In the last couple of years, a lot of our capital has gone into India, Brazil, Colombia and Peru. Those countries all went through a commodity collapse and a lack of capital, and therefore offered more opportunties."

In the firm's latest newsletter, Mr Flatt said Europe and the UK have extremely low rates that are likely to persist, given the political turmoil, demographics and the underlying economies. "Despite this, we're finding many investments that can earn high leveraged cash returns due to the correspondingly low borrowing rates."

He also said the business is positioned to thrive in a higher rate environment for three reasons.

One is that the firm owns "real return" assets that increase their cash flow-generating capacity over time, either through contractual rights or the firm's ability to improve and expand operations.

Second is that the firm generally earns total returns on equity of 10 to 20 per cent, against which "a few percentage point increases aren't material". And, much of its debt is fixed rate debt.

"We still believe that the odds are currently stacked heavily in favour of lower-than-usual interest rates in the US for the medium term, if not longer. With US$50 trillion of savings in the world that need to earn a return and rates in many parts of the world continuing to be very low, these savings are increasingly targeted at the returns and dependability that come from investments in the US. This should keep rates down for a while."