Identifying the Real Opportunities in Real Assets

By Jeff Eaton, Eaton Partners

10 September 2020

Jeff Eaton, who leads origination at placement agent Eaton Partners, tells us why investors should add real assets strategies to their alternatives allocation

Why are real assets a compelling investment opportunity for investors?

We define real assets as those underpinned by hard, tangible assets, which can be very different across real assets strategies. For example, while we would distribute an aviation leasing deal to both private credit and real assets buyers, we would put it in a real assets bucket because the deal is underpinned by the aviation (real) assets.

In the majority of cases, these underlying assets are essential to a process, product, or customer, thus making them largely uncorrelated to economic cycles. More often than not, they're also subject to long-term contracts that produce stable cash flows for long periods of time. This makes them a fundamentally compelling asset and explains why there is so much interest in them.

Why do some investors shy away from real assets?

In our experience, the main reason investors shy away is the return profile. Since the majority of real assets strategies focus on stable operating assets, they offer less risk but generally produce lower returns. Most investors seek higher returns in their alternatives portfolio, so real assets has historically had to compete for allocation dollars with strategies that typically have returned more on investment, like private equity. Today, many LPs see real assets as a key component of their investment portfolios, although allocations might be a larger or smaller piece of the overall pie depending on the type of investor, their risk/return appetite, and their investment time horizon.

What are the most compelling opportunities that you are seeing currently?

There is a lot of investor interest in climate infrastructure, primarily in assets and companies focused on reducing emissions and renewable power generation – where solar and wind projects are the most sought-after sources of energy. We are currently in the market with a renewable infrastructure fund focused on renewable power generation, and investors that normally write $25-50mn commitments are signing up to write $100-200mn. Other sectors offering compelling opportunities include digital infrastructure, sustainable materials, and electric vehicle infrastructure. For the most part, these sectors are not yet overcapitalized, so you can theoretically get stronger returns.

When in the economic cycle is the best time to pursue real assets investments?

The vast majority of investors we engage are large institutions that have a mandate to invest across economic cycles, so they avoid the 'timing' of cycles. Some investors have a more opportunistic approach, with many learning the hard way about the benefits of diversifying and investing across economic cycles. For example, coming out of the Global Financial Crisis, several investors stopped investing in real assets, and some in alternatives in general. The result was many missing out on entry points not seen in a generation. In terms of cycle 'indicators,' historically we've had significant success raising capital for real assets strategies when investors have been anticipating inflation.

How do you think real assets should be viewed in the context of a broader alternative asset allocation?

We believe real assets should have their own allocation within a portfolio. The largest investors have dedicated teams and allocations for real assets and we expect to see more and more LPs follow that path. In our experience, the majority of investors start with a core diversified infrastructure fund as the foundation. As they get more comfortable, they tend to get more specific or specialized in their allocations. Currently, we're having the most success with highly specialized managers – funds focused on areas like digital infrastructure, carbon reduction, and water infrastructure.

Who are the LPs pursuing real assets?

Historically it has been the large public pension funds, sovereign wealth funds, and insurance companies. These types of investors have lower return thresholds driven by their liabilities. These large investors prefer real assets as they offer lower risk and long-term cash flows as the major source of returns. That said, many endowments, foundations, and family offices now have dedicated real assets allocations driven by their desire for diversification and yield. These smaller programs have traditionally focused on multiples, but they are seeing that having some investments in real assets strategies smooths out volatility.

How do you see the sector evolving in the future?

The sector in general will evolve in line with trends in the broader economy. One of the exciting things about being involved in this space is that we constantly see new ideas and new opportunities. Five years ago we weren't talking about the availability of water – now it's at the front of people's minds. Renewable energy and climate infrastructure have also become the most sought-out energy sectors and we expect that trend to continue as policy-makers and the public in general grow more concerned about the environment.

Jeff Eaton *is a member of the Management Committee and leads worldwide origination for Eaton Partners. Based in Houston, Jeff manages Eaton Partners' energy and real asset businesses. He has a diverse background in energy investments and over 20 years of experience in the financial industry. Prior to joining Eaton Partners, he was a Director at Constellation*

Energy Commodities Group leading principal transactions for their natural gas structuring and trading division.

Eaton Partners has participated in raising over $100bn of institutional capital across more than 140 highly differentiated investment funds, including private equity, private credit, real estate, real assets, and hedge funds.