December 2024

Asset Allocation Report – Real Assets

Context

The global economy over the past year has been shaped by persistently high inflation and elevated interest rates, significantly influencing the performance and valuation of real assets. These macroeconomic conditions, combined with emerging trends, have driven divergent outcomes across sectors within the real assets space.

Real estate has been particularly impacted by the "higher-for-longer" interest rate environment, which has elevated borrowing costs and tightened lending standards for real estate loans in both the U.S. and Europe. This, coupled with continued uncertainty about pricing, has resulted in suppressed valuations and cautious investor sentiment. The constrained capital supply has placed additional pressure on the sector, challenging its ability to recover quickly.

In contrast, infrastructure has demonstrated relative resilience. While elevated interest rates have similarly constrained capital supply, infrastructure has not faced the same demand-side challenges as real estate. Within this asset class, renewable energy assets have emerged as a standout performer, driven by robust investor interest and structural tailwinds. The growing adoption of AI and the expansion of data centers have further underscored the need for enhanced power generation capacity, fueling demand for renewable energy infrastructure.

The global economy is expected to grow steadily in 2025, with GDP projected to increase by 1.7-2.0%. This stable environment, combined with anticipated interest rate cuts in Europe and the U.S. and fresh stimulus measures in China, brings renewed optimism for the year ahead. As these factors take effect, demand for real estate and infrastructure is likely to rise, driven by the need for spaces to support business operations, housing, and retail activities, as well as infrastructure to sustain transportation, energy, and communication systems. Together, these trends position 2025 as a year of recovery and opportunity for several sectors within real assets.

North America Focus

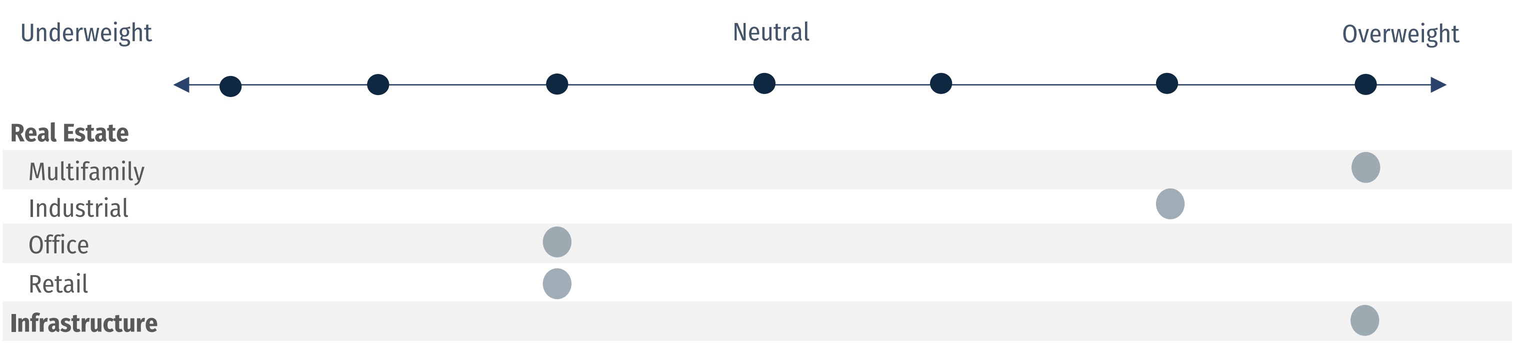
The United States plays a pivotal role in the real estate and infrastructure sectors. As political and economic dynamics evolve, key factors are shaping the future of these asset classes. Overall, a second Trump term could create a favorable environment for growth in real estate and infrastructure, especially considering the following elements:

- **Pro-Business and Pro-Infrastructure Policies:** Trump's administration has been pro-business and infrastructure-focused. This could boost demand for real assets like real estate, transportation, and industrial properties. Increased government spending on infrastructure could directly benefit companies involved in the development of real assets.
- **Tax Reforms and Investment Incentives**: Expanded tax cuts may boost capital investment in real assets, particularly in real estate, energy, and utilities. Lower corporate taxes could also increase the profitability of companies involved in the development and management of real assets.
- **Deregulation**: Trump has focused on reducing regulations in energy, mining, and real estate, potentially boosting investment in natural resources, energy infrastructure, and real estate developments, particularly in energy-rich regions or areas with high growth potential.
- **Inflation and Interest Rates**: If Trump's policies drive inflation, real assets like rental properties and infrastructure with inflation-linked revenues could serve as effective hedges. Additionally, if the Federal Reserve maintains low-interest rates to support economic growth, it could further drive demand for real assets.

While Republicans have criticized the Inflation Reduction Act, a full reversal is unlikely given its broad public support for infrastructure investments. The global push for clean energy drives growth in solar, wind, and farmland, while high renewable transition costs ensure traditional energy sources like natural gas and nuclear remain essential, offering diverse opportunities.

Real Assets Views

The following summarizes the view in private markets based on a 12-month Outlook for each strategy. It is crucial to note that specific considerations will be addressed within these strategies in each of the following commentaries. This view cannot be generalized to all managers as each one is unique.



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Real Estate

Global growth in 2025 is expected to remain stable but subdued, influenced by geopolitical tensions like the war in Ukraine and Middle East instability. Recession fears have eased, inflation has declined from 2023 peaks, and major central banks, the European Central Bank, Bank of Canada, Bank of England, and US Federal Reserve, have shifted toward more accommodative policies, with rate cuts beginning in mid-2024.

By the end of 2025, the US federal funds rate is expected to decline to 3.75%-4.0%, although it will still be significantly higher than pre-pandemic levels. Rate cuts have historically supported real estate activity by reducing borrowing costs in this capital-intensive industry. This cycle is expected to follow a similar pattern, with commercial properties showing solid performance in 2025.

These conditions are likely to bolster the real estate sector by driving rental growth, enhancing yields, and fostering renewed investment.

Tailwinds

Signs of Recovery: The real estate sector is showing early signs of a turning point, with recovery gaining momentum. Rate cuts have begun to drive a rebound in activity by lowering borrowing, easing pressure on both assets and investors.

- The Green Street Commercial Property Price Index® for the core sector rose 6% over the past twelve months.
- According to CBRE, Commercial real estate investment volume increased by 14% in Q2, reaching USD 86 billion, marking a recovery from the 15% decline in Q1. In Q3, investment activity further stabilized at USD 90 billion, down just 2% year-over-year compared to a 49% drop in the same quarter last year.
- The CBRE Lending Momentum Index rose by 13% quarter-over-quarter and 15% year-over-year in Q3, indicating improved lending activity.

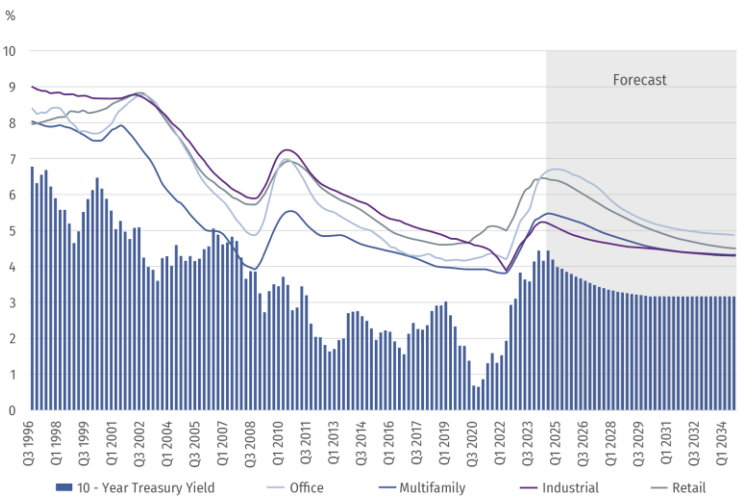
Interest Rate Reductions: The anticipated reduction in interest rates in 2025 is expected to further support the real estate sector by lowering borrowing costs. This will ease pressure on investors and property values, making transactions and investments in commercial properties more attractive.

Historically, interest rate cuts have boosted real estate activity, with noticeable improvements in market conditions typically occurring within 1-3 years after the rate reductions take effect.

Cap rates effect: Cap rates remain above 10-year U.S. Treasuries, highlighting the favorable risk-adjusted returns of real estate investments. This premium reflects investor confidence in the sector's ability to generate stable income amid economic fluctuations.

With continued demand for income-producing assets and favorable trends supporting rental growth, this spread is expected to persist through 2025, reinforcing real estate as an attractive investment. Moreover, a soft-landing scenario is likely to sustain resilient fundamentals in commercial real estate, driving rent growth and income returns, which in turn could further compress cap rates.

Historical and projected cap rates



Source: CBRE Econometric Advisors

Supply Constraints: High construction costs and limited debt availability have constrained the supply of real estate assets, creating a favorable environment for existing properties. At the same time, demand for multifamily and industrial assets remains strong, driven by a robust labor market and favorable economic conditions. As a result, rental growth is expected to accelerate, positioning these sectors for strong performance in the coming years.

Strong Fundamentals: The real estate market in 2025 is expected to show uneven performance across different sectors. The industrial and residential sectors are likely to remain strong, supported by balanced supply and demand dynamics, as well as favorable vacancy rates.

- In the U.S., multifamily properties are gaining attention due to favorable economic conditions, including lower 10-year Treasury yields and rate cuts from the Federal Reserve. Housing demand continues to exceed supply, lowering vacancy rates and paving the way for potential rent increases. The U.S. faces a shortage of 2.8 million homes, with construction units barely meeting the pace of population growth. Factors such as smaller household sizes and an increase in single-person households further heighten this demand.

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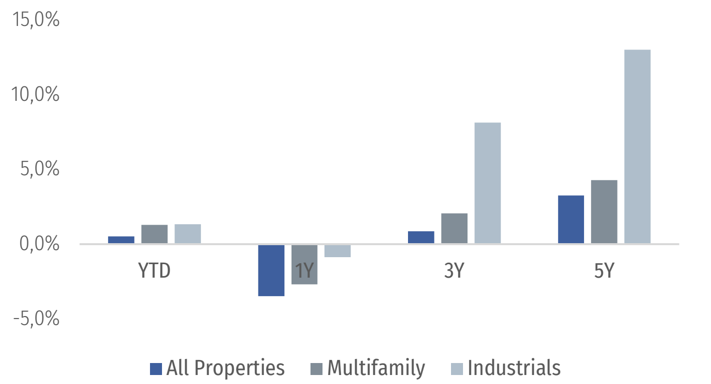
- The industrial sector shows remarkable resilience during the rising interest rates cycle. This is driven by e-commerce growth during the pandemic and the expanding demand for data centers, fueled by the rise of artificial intelligence. While e-commerce activity slowed as consumers returned to brick-and-mortar stores, it has stabilized and now aligns with pre-pandemic growth levels, keeping the storage and logistics sectors robust.

Return by property type



Source: 'All properties' refers to the NCREIF Property Index, 'Multifamily' refers to the NCREIF Property Index Apartments, and 'Industrials' refers to the NCREIF Property Index Industrials, as of September 2024. Annualized returns, except for YTD. These indexes are benchmarks that measure the performance of institutional-grade real estate investments in the United States. They include properties owned by institutional investors, providing insights into total returns, which encompass both income generated and appreciation in property value.

Headwinds

Sector-Specific Imbalances in Supply and Demand:

- The office space segment is still facing demand challenges, particularly as remote work remains prevalent in many industries. The oversupply of office spaces in certain cities may exacerbate this issue.
- The rise of online shopping suppresses demand for traditional retail spaces, especially in lower-tier malls. The retail real estate sector faces several challenges heading into 2025, many of which are tied to changing consumer behaviors, economic conditions, and the evolving landscape of retail itself: Shift to E-Commerce and Omnichannel Shopping.

Careful market and asset selection will be critical for navigating these disparities and capitalizing on opportunities in the evolving landscape.

Inflation: Persistent inflation could continue to challenge the real estate market, especially in terms of higher construction and operational costs. Although inflation has eased compared to previous peaks, it remains a risk for property prices and financing costs.

Continued High Borrowing Costs: Although interest rates are expected to decrease in 2025, they will remain above pre-pandemic levels. This prolonged period of elevated borrowing costs could limit investment, especially in speculative or high-risk real estate projects.

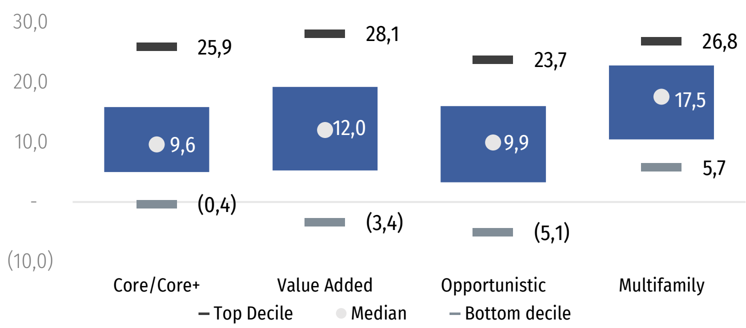
While there has been a shift away from further rate increases, the focus is now on maintaining higher rates for longer compared to the ultra-low levels of the past decade, making financing more expensive and slowing investment activity in certain sectors.

Areas of Focus

- **Multifamily:** There is sustained demand for multifamily housing, particularly in the U.S., where limited affordable inventory and rising construction costs create a significant mismatch between supply and demand. This makes multifamily units a critical housing option for those unable to purchase homes. Additionally, declining mortgage rates will likely support growth in this segment.
- **Demand for Industrial and Logistics Properties**: The growth of e-commerce, nearshoring, and reshoring continues to drive demand for industrial properties. In particular, logistics centers and data centers, fueled by advancements like AI, are expected to see strong growth. This segment is bolstered by the ongoing scarcity of new industrial construction, which can drive higher occupancy rates and rental growth.
- **Mixed-Use Development**: The trend toward mixed-use development is reshaping urban landscapes, with retail spaces becoming increasingly integrated with residential, office, and entertainment venues. This boosts foot traffic, diversifies revenue, and enhances resilience to market fluctuations. Driven by demand for live-work-play environments, this trend is expected to grow, offering convenience, sustainability, and diverse income opportunities.

Investors can capitalize on these areas of focus by investing specifically in Core/Core+ strategies, which target stable, income-generating properties driven by strong demand-supply dynamics and favorable economic conditions. Value-Added strategies are also viable, particularly in sectors showing early recovery signs. The soft-landing economic scenario, combined with rising rent growth and favorable cap rate trends, creates opportunities for value enhancement through active management.

Net IRR (Vintage 2000-2019)



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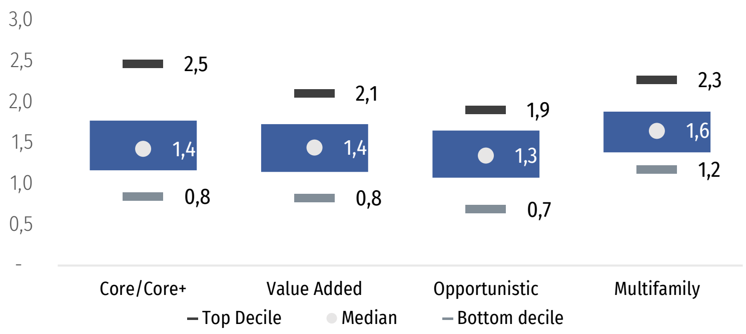
Net TVPI (Vintage 2000-2019)



Source: Preqin, based on the most up-to-date data as of December 10, 2024. Analysis conducted by HMC. Core/Core+ includes an average of 214 funds, Value-Added includes 735 funds, and Opportunistic includes 460 funds. Multifamily refers to closed-end funds focused specifically on multifamily properties, comprising an average of 77 funds. These multifamily funds can also be included in other strategies such as Core/Core+, Value-Added, and Opportunistic. The purpose of showing them separately is to provide insight into the returns of this specific segment.

Infrastructure

Infrastructure remains a cornerstone of private market investments, offering stable, inflation-protected cash flows while benefiting from long-term structural trends.

Transportation and urbanization are rebounding post-pandemic, energy infrastructure is gaining prominence amid geopolitical conflicts, and digital and renewable energy transitions continue to build momentum. Enduring trends are strengthening the structural case for infrastructure, while the cyclical case—bolstered by the prospect of lower interest rates—further enhances its appeal. Together, these factors highlight infrastructure's resilience and diversification potential in an environment of economic uncertainty.

Tailwinds

Energy and Sustainability: Infrastructure investments are essential to advancing global sustainability goals. Initiatives like the U.S. Inflation Reduction Act and the EU's Green Deal have unlocked unprecedented funding for renewable energy, energy storage, and grid modernization, with over USD 500 billion in new projects projected by 2026.

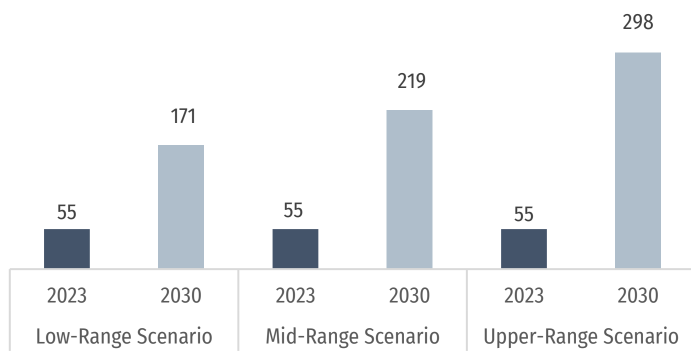
Renewable energy projects such as wind, solar, and battery storage lead the way, supported by government incentives and corporate ESG commitments. However, the significant upfront costs of transitioning to renewables ensure that traditional energy sources like natural gas and nuclear power will remain vital, sustaining investments in related infrastructure.

Additionally, traditional energy sources will continue to provide a reliable power supply, balancing the intermittency of renewables and acting as gap-fillers until advancements in renewable energy, storage, and other technologies can fully meet demand.

Digitalization: Digital infrastructure, including data centers, fiber-optic networks, and 5G rollouts, is rapidly expanding, driven by AI adoption, cloud computing, and the surge in connected devices.

Global demand for data centers is expected to increase fivefold by 2030, with emerging markets like Latin America playing a key role. The rise of generative AI is further amplifying this trend, with power demand for data centers projected to grow by 160%, increasing the need for advanced digital infrastructure. Additionally, the computational and cooling needs of data centers are driving a sharp rise in electricity demand, reinforcing a long-term structural theme in global infrastructure.

Global Demand for Data Center Capacity (Gigawatts)



Source: McKinsey Data Center Demand Model as of October 29, 2024.

Inflation: Inflation can act as a tailwind for infrastructure investments, as many assets benefit from inflation-linked revenues through long-term contracts or regulated pricing. However, high inflation can also increase operating and financing costs, particularly for greenfield developments, and rising interest rates may impact valuations. Despite these challenges, the asset class is effective at preserving real returns and providing a hedge against rising prices.

Resilient Demand: Core infrastructure assets, such as utilities, transport, and social infrastructure, provide essential services with inelastic demand, ensuring stability even during economic downturns.

Policy-Driven Growth: Government-backed infrastructure spending remains robust, with significant investments in both developed and emerging markets. Urbanization in Asia and Latin America continues to create demand for transport and energy infrastructure.

Headwinds

Interest Rate Sensitivity: Infrastructure investments often rely on significant debt financing, and rising interest rates can increase the cost of capital. This may comprise the margins, reduce returns on leveraged infrastructure projects or extend timelines for project completion.

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Market competition: The growing interest in infrastructure as an asset class has intensified competition for high-quality brownfield assets, driving up valuations and compressing yields. This is further compounded by substantial capital raised by infrastructure funds, much of which remains uninvested due concerns about overpaying.

This accumulation of dry powder adds urgency, further driving up valuations as managers face pressure to deploy capital within their investment periods, creating a highly competitive market environment.

Area of focus

Strategic Focus on Trend-Driven Infrastructure Opportunities: managers who can capitalize on structural and secular trends within infrastructure, such as the transition to renewable energy, the expansion of digital infrastructure, and the modernization of aging assets. These trends present long-term opportunities for value creation and resilience in a competitive market.

Managers adept at navigating these shifts and developing innovative strategies are well-positioned to deliver sustainable returns and meet evolving global needs.

Shift Toward Brownfield Investments: Investors should prioritize core and core+ brownfield assets, such as toll roads, airports, and regulated utilities, which offer stable cash flows and lower execution risks compared to greenfield projects, meeting the demand for resilient investments.

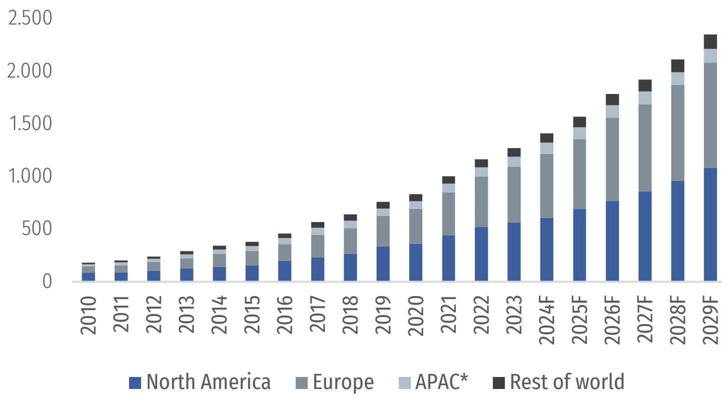
Value-added strategies, particularly in renewable energy and digital infrastructure, also present attractive opportunities for those willing to accept moderate risks in exchange for higher potential returns.

Regarding geography, both Europe and North America offer attractive opportunities for private infrastructure investments, each with distinct characteristics.

Europe provides a more diversified landscape across sectors such as transportation, digital infrastructure, and utilities, offering broad exposure for investors. In contrast, North America has a stronger focus on energy-related investments, driven by the ongoing energy transition and significant infrastructure renewal needs. For example, the United States led renewable deal value with a 39.2% share in Q1-Q3 2024, followed by Europe with 30.1%, according to Preqin.

It is expected that North America and Europe will lead infrastructure AUM with similar levels, underscoring their importance as key regions for private infrastructure investment strategies. By tailoring approaches to these regional dynamics, investors can maximize their opportunities in these leading markets.

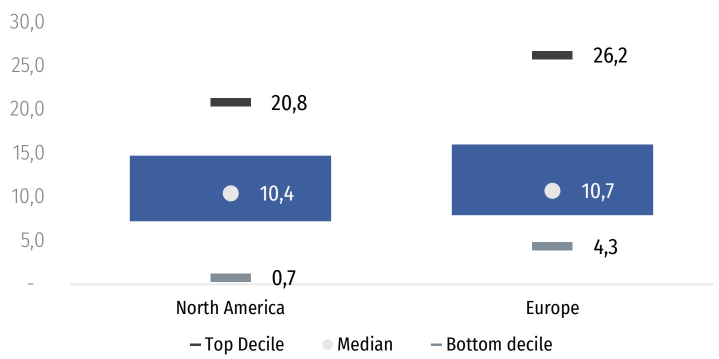
Infrastructure AUM by region focus



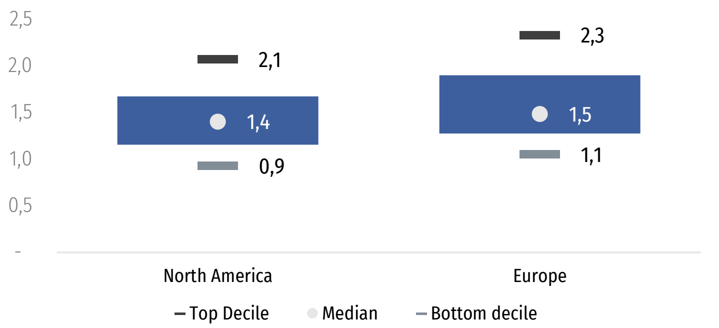
*Source: Preqin Pro. * AUM figures exclude funds denominated in yuan renminbi*

In terms of performance, median returns between North America-focused funds and Europe-focused funds have shown similarity, indicating a comparable baseline performance. However, European funds have demonstrated a higher top decile performance, showcasing a wider dispersion in returns. This suggests that both regions offer good opportunities for investors, with Europe showing a wider range of outcomes, highlighting the importance of manager selection in achieving strong performance.

Net IRR (Vintage 2000-2019)



Net TVPI (Vintage 2000-2019)



Source: Preqin, based on the most up-to-date data as of December 13, 2024. Analysis conducted by HMC. North America-focused funds total approximately 176, while Europe-focused funds account for around 160.