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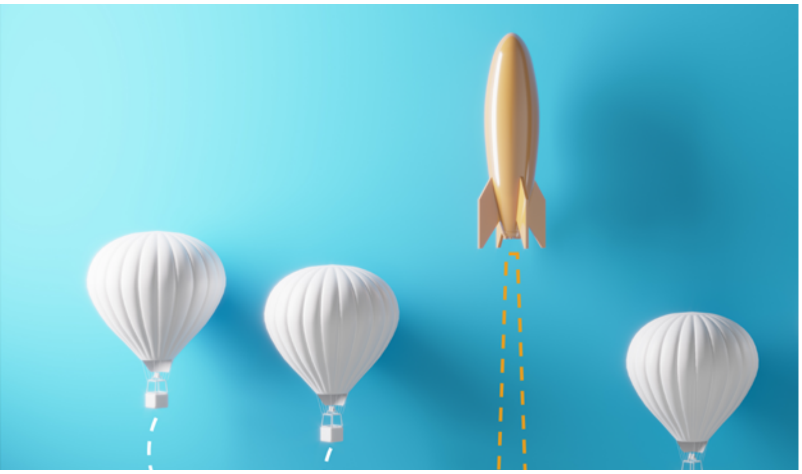
The Role of Private Alternatives IN HEDGING INFLATION

A Closer Look at Infrastructure, Real Estate, and Agriculture

Investors have given little thought to inflation until recently as it has remained largely in check even though the 2008 financial crisis and the COVID-19 pandemic prompted some central banks to engage in quantitative easing — buying longer-term securities to increase the supply of money and lower interest rates. The central banks' approach has kept borrowing costs low and helped keep economies afloat through the pandemic. However, the prevalence of this "cheap" money now may contribute to rising commodity prices and bubbles appearing in certain asset classes.



While investors have seen no meaningful inflation in the past two decades, is the time for complacency over? The US Consumer Price Index (CPI) rose 0.5% in July 2021 and was up 5.4% compared to the prior year, on pace with the rise in June and above the 5% gain in May. May's increase was the largest spike in consumer prices since August 2008, more than a decade earlier. Data for August showed some moderation, with the price index rising 0.3% for the month and 5.3% for the year.

As signs of inflation emerged in economies around the globe, news outlets echoed a common refrain:

- Producer prices climb 6.6% in May on annual basis, largest 12-month increase on record[1]
- European investors are concerned that inflation might begin to hit their portfolios as Western economies lift COVID-19 related restrictions[2]
- Bank of Canada pares back bond buying, raises inflation forecast[3]
- Eurozone inflation hits decade high as bottlenecks bite[4]
- South Korea inflation at 9-year peak fuels rate hike expectations[5]
- Food price inflation heaps pressure on poorer countries[6]

In testimony to Congress in mid-July, US Federal Reserve Chairman Jerome Powell acknowledged that inflation "has increased notably," but he characterized the increase as temporary, resulting from pent-up consumer demand and pandemic-related supply-chain disruptions. However, the Fed's continued quantitative easing spurred criticism from some US lawmakers and others who feared that it was fanning inflation.

Indeed, the Fed's own consumer survey found median inflation expectations rose in August to an expected 5.2% in the short-term (one-year horizon) and 4.0% in the mid-term (three-year horizon), a record high for the survey launched in 2013.

Inflation has been called the bane of central bankers, but it also can be the bane of certain investors and investment classes. High inflation in the 1970s slashed values of stocks, bonds, and other traditional assets. Alternatives such as infrastructure investing gained momentum in the late 1990s and early 2000s amid concerns that real returns on equity and fixed-income investments would suffer in an inflationary environment.

This report takes no position on whether the current increase in inflation will be short-lived or longer lasting. Instead, it offers insights from our Private Alternative teams on how certain alternative investments might perform within an investor's portfolio should inflation continue to rise in the future. We focus on three – infrastructure, real estate, and agriculture.

1 CNBC, June 15, 2021 Jeff Cox. 2 Pensions&Investments, May 31, 2021. 3 The Globe and Mail, July 14, 2021, Mark Rendell. 4 Wall Street Journal, August 31, 2021, Paul Hannon. 5 Reuters, September 1, 2021, Joori Roh. 6 The Financial Times, September 13, 2021, Jonathan Wheatley.

INFRASTRUCTURE

Infrastructure often has been the responsibility of governments, but with many facing fiscal challenges, private capital is becoming increasingly involved both in standalone investments and public-private partnerships. Unlike traditional assets, infrastructure is less vulnerable to economic cycles and historically has been associated with stable and reliable cash flows and returns.

Investors are drawn to infrastructure assets because they offer long-term capital appreciation and near-term distributions and cash flow, all while supporting projects that are essential to key sectors of society such as utilities, renewable energy projects, telecom-related infrastructure, and transportation.

A carefully constructed and diversified infrastructure portfolio should act as a hedge against inflation since its revenues should have low correlations to gross domestic product (GDP). Whether the economy is weak or strong, people will turn on the tap each morning to brush their teeth, making the demand for water inelastic.

As an example, Fiera's EagleCrest Infrastructure portfolio provides contractual linkage to inflation as well as pricing power to effectively pass through the impacts of inflation. The entire EagleCrest portfolio has some inflationary mitigation, with a significant amount of revenue directly linked to inflation through regulation, concession agreements or contracts.

Fiera Infrastructure's largest investments include Conterra Networks, a US broadband provider, Cory, a UK recycling and resource management firm, and Wightlink, a ferry operator serving the Isle of Wight in the UK. As shown in the chart below, we evaluate that the inflationary impact on asset cashflows would be positive for the three assets.

This inflation hedge is by design. If Cory's costs increase as a result of inflation, investors do not bear those costs as Cory's gate fees and electricity sales are underpinned by long-term inflation-indexed contracts with high-quality municipal, corporate, and industrial customers. Conterra Networks regularly enters into new contracts with customers, allowing it to reflect the costs at the time the contract is executed. Conterra Networks has a mix of shorter- and longer-term contracts that expire at different times. This provides investors with the security of longer-term contracts while also providing an inflation hedge from contract renewals at prices that reflect the cost at the time.

ASSET[7]	SOURCE(S) AND DESCRIPTION OF INFLATIONARY HEDGING	INFLATIONARY IMPACT ON ASSET CASHFLOWS[8]
Conterra Networks	• ~10% of current revenue is contractually linked to inflation given the shorter term contract length. • Upon contract renegotiation, increased pricing as a result of inflation would typically be passed through to the customers, offering a certain level of inflation hedging.	POSITIVE
Cory	• ~60% of Cory's revenues are contractually linked to inflation. • For the revenue that is not contractually linked to inflation, such as the Commercial and Industrial waste contracts, Cory is able to renegotiate pricing on renewal and would subsequently look to pass through inflation and possibly further rate increases.	POSITIVE
Wightlink	• Wightlink is a GDP-linked asset and has no contractual revenue streams. • There are no pricing regulations and management is able to control its pricing, and as such, would be able to adjust its ticket prices accordingly for inflation.	POSITIVE

Source: Fiera Infrastructure data as of Dec. 31, 2020.

7 Asset selection is based on the top 3 holdings within the EagleCrest Infrastructure portfolio. 8 Positive impact on asset level cashflows is expected in an inflationary environment due to index-linked revenues increasing more than expenses. Assets with uncontracted revenues have favorable pricing dynamics and can therefore pass inflationary effects through to customers.

REAL ESTATE

Historically, when inflation rises, real estate prices and rents also rise. Given this historical correlation, in periods of higher inflation, institutional investors may increase their capital allocations to real estate.

Over the next few years, as economies recover from COVID-19 lockdowns, real estate offers an opportunity to outperform in an expected demand-pull inflation rebound. The increased demand for real estate will be beneficial for landlords using CPI-linked leases.

In an inflationary environment, we would expect to see a gradual rise in interest rates, which could affect discount rates and result in tempered values. However, we expect rental growth benefits are likely to more than offset this effect.

When constructing a real estate portfolio, it is critical to integrate proactive inflationary management into the leasing and operating platform. This would typically take the form of a leasing process that is geared towards effectively protecting against inflation through its lease structuring, as follows:

- Contractual base rent steps/increases and an emphasis on achieving steps, especially for longer-term leases. This allows for steady rent growth over the term of the lease and is designed to capture inflationary growth assumptions.
- Operating expenses and capital/building work are subject to inflationary increases; however, these are generally passed through or recovered from tenants contractually via triple net-type leases. This shifts the risk of increased expenses and capital program costs to tenants.
- Active management of current and future vacancies, where the landlord would potentially absorb cost increases; however, this risk is minimized with an active leasing program and strong market fundamentals.

Impact of Inflation on Major Real Estate Property Types

MULTI-RESIDENTIAL

Residential leases are predominantly short-term, typically 12 months, allowing for rapid adjustments to rent levels on new tenants, and inflationary increases for renewals where regulated. This provides low sensitivity to inflation risk.

RETAIL

Retail leases vary greatly based on term and cost pass-throughs. For example, grocery store anchors typically have long-term leases and often have improved finances in higher inflation environments, while smaller tenants have short and medium-term leases. Investment managers can reduce inflation risks with proactive risk-management programs.

OFFICE

Office leases are often long-term, frequently 5-10 years, placing this sector at potentially higher sensitivity to inflation risk. However, investment managers with proactive inflation management strategies can reduce this risk with CPI-linked leases and triple net pass-through of costs. Further, the office sector is pro-cyclical, so that inflation driven by a strong economic rebound can result in increased demand and higher rents.

INDUSTRIAL

Industrial leases are often medium to long-term. However, due to oversupply, many properties currently have below-market rents.[9] This provides a strong inflation hedge, especially in economic rebounds. Investment managers that strategically manage industrial lease terms allow for rent growth to be realized quickly.

9 CBRE Q1 2021 MarketView Report.

Built with this in mind, a portfolio can withstand movements in inflation.
The chart below shows examples of active inflation-protection strategies:

ASSET	SOURCE(S) AND DESCRIPTION OF INFLATIONARY PROTECTION	IR SENSIVITY (+100BPS INFLATION)	IR SENSIVITY (-100BPS INFLATION)
Office & Data Centre – GTA Asset	• Large office/data centre located in the Greater Toronto Area (GTA), valued at approximately C$200+ million. • Occupancy is 99%+ on 550,000 sq. ft. and home to one of Canada's major banks on a long-term lease to 2030+. • Notable other tenants include long-term leases with a financial services firm and a global technology provider. • Contractual annual rent escalations in tenant leases provides steady rent growth and captures inflationary growth. • Recovery of operating expenses on full pro-rata share, with direct pass-through of utility charges to tenants, shifts the risk of expense and capital program cost increases to tenants, protecting againt expense inflation.	(0.2BP) NEGATIVE IMPACT on 653 bps of annualized Income Return (negligible)	1.2 BP POSITIVE IMPACT on 653 pbs of annualized Income Return (negligible)
Retail Asset	• Large retail property located in Ontario, valued at approximately C$80+ million. • Occupancy is 96%+ on 365,000 sq. ft. and the centre is anchored by an international grocery/department store. • Contractual annual/bi-annual rent escalations in place for all tenants with 2024+ lease expirations providing steady rent growth, certainty, and protection against future inflationary growth. • Recovery of operating expenses, subject to certain floor and caps, is a direct pass-through to tenants and is near current occupancy rates, which shifts the risk of expense and capital program cost increases from the owner. • Tenant leases include percentage rent clauses, where the tenant pays a higher rent based on achieving positive sales above pre-determined levels, allowing the landlord to benefit from tenant sales growth.	(0.4BP) NEGATIVE IMPACT on 694 bps of annualized Income Return (negligible)	1.4 BP POSITIVE IMPACT on 694 pbs of annualized Income Return (negligible)

Similar inflation protection is seen in individual property holdings. A large Ontario retail property valued at approximately C$80 million is more than 96% occupied, and all leases include contractual annual or biannual rent escalations to protect against inflation. An office and data center in the greater Toronto area valued at more than C$200 million is 99% occupied by tenants holding long-term leases with annual rent escalations. In both holdings, direct pass-through of utility charges shifts the risk of expense inflation to tenants. As a result, property income performance is projected to remain strong even in the face of inflationary pressures.

AGRICULTURE

Investor interest in agriculture has been increasing and is likely to continue to do so in an inflationary environment. Food is a necessity for daily life, and the farmland where it is grown provides an effective hedge against inflation. Generally, higher food prices translate into higher farm revenues and increasing land value.

To be sure, in an inflationary environment, the cost structure of agricultural assets could be negatively impacted. However, over the longer term, commodity prices tend to adjust, protecting margins. In addition, farmland benefits from productivity increases due to new technologies, genetic engineering, and improvements in farming practices. Investing in agricultural assets that are low on the cost curve is key to facing inflationary pressures.

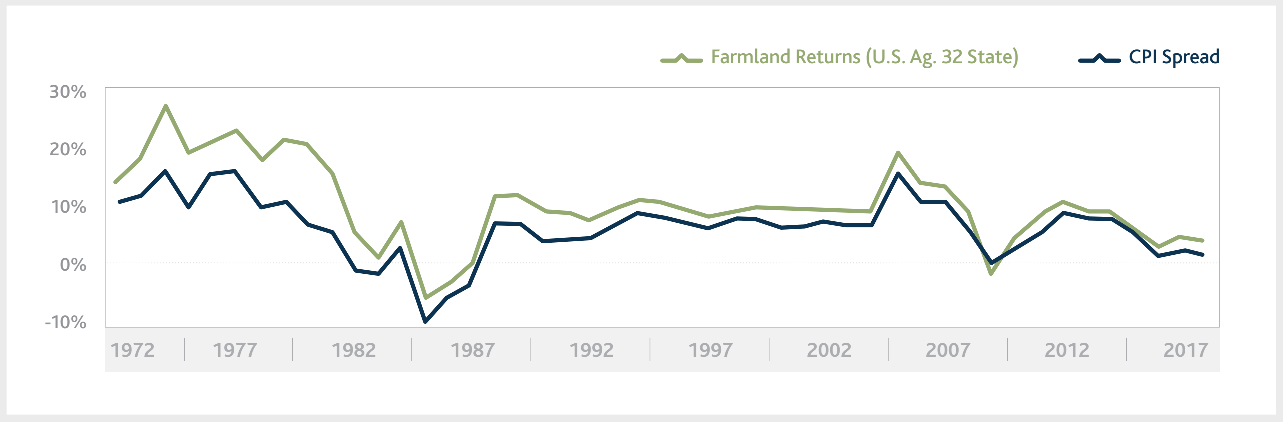
Importantly, rising interest rates are less of a factor in the agricultural sector as it boasts low leverage with debt generally subject to fixed interest rates. On the whole, the interest rate impact is immaterial as it is offset by higher operating cash flows due to rising commodity prices.

It is worth noting that food prices spiked during the global pandemic, and agricultural assets performed well, increasing in value and generating more income in nearly every major developed market in 2020. Moreover, the pandemic has heightened focus on healthy diets, with consumers in developed countries shifting more toward organic products in all food categories, a trend that will push up land values, particularly for properties able to undertake organic production.

Diversification is key in the agriculture sector as a well-diversified portfolio can greatly mitigate commodity market volatility. Fiera Comox Agriculture's acquisition of 4,500 acres of prime agricultural land in California, mostly configured for almond production, is reflective of our ongoing commitment to building a diversified global portfolio of agricultural assets. With global consumption growing, we believe almond production offers attractive cash yields for investors. We invest in such assets with the goal of generating stable, attractive returns over the long-term with low correlation to most other asset classes.

Agriculture and other alternative investments offer investors potential protection from inflation, which former Bundesbank President Karl Otto Pohl described as being like toothpaste. In his view, "Once it's out, you can hardly get it back in again." If inflation spills out of control, investors will want investment portfolios that can withstand the mess it creates and the clean-up effort required of central banks. In that event, investments in Infrastructure, Real Estate, and Agriculture may play an important role as a hedge against rising prices and decreasing purchasing power — something to consider the next time you brush your teeth.

The chart below shows the return from US farmland and spread over annual inflation over more than three decades:
Farmland Return and Spread Over Annual Inflation, 1972-2018



Sources: Bloomberg, NYU Stern, Farmland: USDA Average US Farmland Values per acre, FarmFundr, U.S. Bureau of Labor Statistics, TIAA Center for Farmland Research as of 2018.

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Important Disclosures