

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Using Leverage to Improve Returns in the Real Assets Space



LARRY ANTONATOS is Managing Director and Portfolio Manager of Brookfield Asset Management Inc., Public Securities Group. Mr. Antonatos has over 25 years of investment experience and is a portfolio manager for the Public Securities Group's Diversified Real Assets Strategy. Before joining the Diversified Real Assets team, Mr. Antonatos was a product manager for the firm's equity business, where he was responsible for the development and growth of new and existing investment strategies. Prior to joining the firm in 2011, Mr. Antonatos was a portfolio manager for a U.S. REIT strategy for 10 years. He also has investment experience with direct property, CMBS and mortgage loans. Mr. Antonatos earned a Master of Business Administration degree from The Wharton School, University of Pennsylvania and a Bachelor of Engineering degree from Vanderbilt University.

SECTOR — GENERAL INVESTING

TWST: What is your role in the firm, and what fund did you want to discuss today?

Mr. Antonatos: At Brookfield, we are a manager of real asset investments. My part of the firm invests only in publicly traded securities — public stocks and bonds — and we are focused on real estate, infrastructure and, to a lesser extent, natural resources. I manage two funds; both are diversified real asset strategies. The Brookfield Real Asset Securities Fund is an open-end mutual fund that is predominantly equities with a bit of debt. We also have the Brookfield Real Assets Income Fund, a closed-end fund that is predominantly debt with a bit of equities.

Today, I would like to discuss the closed-end fund, which has an income focus and which we launched on December 5, 2016, by consolidating three specialized legacy Brookfield closed-end funds into one new fund with a broader investment mandate. The legacy funds were two mortgage securities funds and one high-yield fund. We consolidated those three funds, and the new fund is investing in mortgage securities, high yield debt of real asset companies and also equities of real asset companies. The new fund's ticker is RA and was created from the reorganization of ticker BOI, Brookfield Mortgage Opportunity Income Fund; ticker HTR, Brookfield Total Return Fund; and ticker HHY, the Brookfield High Income Fund.

TWST: Can you tell us what assets are currently under management?

Mr. Antonatos: Each of the legacy funds was modest in size, with net asset value of approximately \$200 million to \$400 million. The new RA fund is approximately just under \$1 billion of net asset value.

TWST: Why does an investor want to choose a closed-end fund?

Mr. Antonatos: We believe a closed-end fund is an excellent structure for investing in less liquid securities. In this fund, the mortgage securities are the less liquid securities in the portfolio, currently representing approximately 50% of the fund. Closed-end fund structures tend to be good for less liquid securities because the capital does not flow in and out like an open-end fund. Accordingly, fund managers have the opportunity to take positions in less liquid securities, knowing that they can be held to the maturity of the investment thesis without the risk of a forced sale due to capital outflows.

A second reason why investing in a closed-end fund is attractive is that closed-end funds, including this one, typically use leverage to improve returns. That's exactly what we have done here. We target running this fund with leverage of approximately 25% of managed assets, although the percentages could change over time depending on several factors, including the markets.

TWST: What other rules are applied to the fund as you manage it?

Mr. Antonatos: The two most important rules are leverage and asset type. In terms of leverage, the fund is governed by the 1940 Act rules, which limit leverage to 33 1/3% of the managed assets or 50% of the net assets of the fund. In terms of asset type, this is a real assets fund, and there is a requirement that 80% of managed assets be invested in real assets securities. This means securities in the real estate, infrastructure and natural resources spaces.

We tend to think about this fund as a dynamic asset allocation fund. Because we are investing in public markets, there are always

cycles up and down. My job is to shift the asset allocation of the portfolio over time to take advantage of valuation opportunities. One of the things that we have done recently, for example, is to add U.S. energy master limited partnerships to the portfolio. That was our first significant investment in real asset equities.

perspective, when spreads are wide, that indicates cheap, and when spreads are tight or narrow, that indicates expensive. These yields and yield spreads are important for both fixed income and equities because the real asset equities that we invest in — principally real estate and infrastructure equities, including MLPs — tend to pay a healthy coupon.

“The two most important rules are leverage and asset type. In terms of leverage, the fund is governed by the 1940 Act rules, which limit leverage to 33 1/3% of the managed assets or 50% of the net assets of the fund. In terms of asset type, this is a real assets fund, and there is a requirement that 80% of managed assets be invested in real assets securities.”

TWST: Can you describe your investment process a little bit more thoroughly?

Mr. Antonatos: At Brookfield, we are very much value investors. We are very focused on the real asset spaces, and we think we have deep knowledge of these spaces. One potential way to generate attractive investment performance over time is to use this deep knowledge, together with valuation discipline, to be contrarian. It is important to buy things when they are out of favor and to sell things when the market loves them, because at that point, the price is probably maximized.

MLPs, which I just mentioned as a recent addition to the portfolio, are a good example. MLPs have been under tremendous pressure, as oil prices collapsed from around \$100 a barrel in late 2014 to a low of below \$30 a barrel in February of 2016 and now appear to have stabilized at about \$50 a barrel. MLPs own pipelines that connect oil wells and gas wells with a local network of pipelines that feed into a longer-haul network of interstate or transcontinental pipelines that transport oil and gas to refineries. There is also a network of pipelines that go from refineries to the ultimate users of the refined product. This energy-infrastructure space has been under pressure as energy prices have been under pressure. We saw this as a valuation opportunity and added MLPs to the portfolio.

TWST: Can you talk a little bit more about the process that you use internally to discuss how the fund should be run, whether you should be removing holdings or not? And to what degree is it quantitative?

Mr. Antonatos: Our process seeks to add value on two levels, asset allocation and security selection. Thinking about asset allocation, we look closely at valuation metrics for the fixed income and equity asset classes in which we invest. Metrics we consider include, but are not limited to, absolute yields, yield spreads to 10-year Treasuries and yield spreads to BBB bonds. From a valuation

But with the equities, we also look at multiples. We frequently look at EV to EBITDA multiples, meaning enterprise value to earnings before interest, taxes, depreciation and amortization. We look at the absolute level of multiples and also the relative-to-the-equity-market level of multiples — for example, the multiple on infrastructure equities versus the multiple on the MSCI World Index. That is the quantitative part of what we do.

On top of that, we look on a more qualitative basis at the fundamentals in each of these spaces — for example, the fundamentals of the mortgage market, where we are investing in both commercial mortgages and residential mortgages. Consumer confidence, employment growth, credit quality of consumers are all important drivers of housing demand and home price appreciation. In the commercial mortgage market as well as the real estate equity market, we are assessing the supply, demand and pricing around property markets — for example, the supply of office space versus demand for office space, the pricing from a rent perspective and the pricing from an investment perspective to purchase a building. We want to own more of the asset classes where the valuations are cheap and the fundamentals are getting better, as that sets us up for potential outperformance.

From a security-selection perspective, we use a quantitative process that considers quality-adjusted fair valuation for each security. We score companies on multiple quality factors and assign a higher fair valuation to higher-quality companies. We seek to own securities of companies across the quality spectrum that are trading at discounts to quality-adjusted fair value.

TWST: Do you have any rules about holdings, as far as timing, on how long you will hold something or certain criteria by which you would remove something?

Mr. Antonatos: We don't have any time-based rules, nor any stop-loss or forced-sale rules. What we do have is a process of reviewing the investment thesis of securities that underperform. For example, if a

Highlights

Larry Antonatos discusses Brookfield Asset Management Inc. and the Brookfield Real Assets Income Fund. Three legacy funds were consolidated to create this new closed-end fund. The Brookfield Real Assets Income Fund invests in mortgage securities, high yield debt of real asset companies and equities of real asset companies. Mr. Antonatos believes a closed-end fund is a good structure for less liquid securities, such as mortgage securities. This structure gives managers the opportunity to hold these less liquid positions until maturity without the risk of a forced sale. He also finds a closed-end fund attractive because it uses leverage to improve returns. Mr. Antonatos identifies as a value and contrarian investor. Companies discussed: Nomura Holdings (NYSE:NMR) and Hilton Worldwide Holdings (NYSE:HLT).

security has underperformed, but there has been no relevant news, we would likely not sell that security because that security has in fact gotten cheaper while our investment thesis has remained the same. We actually might increase our position rather than sell that position.

As I mentioned, we do think of ourselves as contrarian managers, and this kind of review, re-underwriting and re-evaluation is consistent with our view that it is valuable to be contrarian, although sometimes it can be tough going. You don't always get the timing right, but in the long run, attractively valued securities tend to outperform.

TWST: What does it mean to be contrarian when you are talking about these types of assets?

Mr. Antonatos: Let me go back to the MLP example, which is energy infrastructure, a space that has been under tremendous pressure, as we previously discussed. To be contrarian is to believe that, while oil price volatility may continue, in the long run, the energy-infrastructure space is likely an attractive space. It is an out-of-favor space in many people's minds because there is the sensitivity to oil prices. Our view is that the sensitivity may be less than people expect. We are actually relatively confident that oil prices will remain in a trading range, rather than dramatically decline in the foreseeable future.

TWST: Can you talk about some of your other positions or holdings and why you have them?

Mr. Antonatos: In the high yield portfolio, we have the ability to invest in natural resource companies, which we do not do in the equity space. Natural resources include agriculture, timber, energy, metals and mining. Within natural resources, we continue to be a little

“Generally speaking, in the mortgage-backed securities portfolio, we have the ability to invest in residential mortgages and commercial mortgages. We are currently bullish on the residential market in the U.S. We think home price appreciation, which has been approximately 5% per year for the past few years, will continue.”

bit concerned about energy because there still is the likelihood of continued oil price volatility. Accordingly, in our bond portfolio, we prefer to get energy exposure by investing in energy infrastructure rather than directly in energy. This illustrates an important distinction of the infrastructure asset class overall.

Each infrastructure industry is typically the lower-risk part of that broader industry. Infrastructure includes oil and gas pipelines, electric and water utilities, communications infrastructure, like cellphone towers, and transportation infrastructure, like airports, seaports and toll roads. Energy infrastructure is generally lower risk than energy exploration and production. Airports are typically much safer and more predictable relative to airlines. This is an important characteristic of this real assets portfolio, particularly for the infrastructure space. It is generally a lower-volatility space.

TWST: How did you come to arrive at some of the choices that were made recently? I see some names amongst your top-10 holdings like Wachovia, Nomura (NYSE:NMR), Hilton (NYSE:HLT), etc. Can you maybe go into detail as to why they were chosen?

Mr. Antonatos: Generally speaking, in the mortgage-backed securities portfolio, we have the ability to invest in residential mortgages and commercial mortgages. We are currently bullish on the residential market in the U.S. We think home price appreciation, which has been

approximately 5% per year for the past few years, will continue. We are currently bullish on the residential market due to the strength of the consumer. Also, from a supply-and-demand perspective, although homebuilding continues to increase, we are still building far fewer new homes than we have built historically on average. That is probably good for fundamentals.

In contrast, we think commercial mortgage fundamentals and commercial property fundamentals on average are generally fine but not great. Supply and demand are generally in balance across most markets. Valuations for property and for mortgage bonds are generally fair. But what we see is a dispersion across markets and property types where things are significantly better than average and significantly worse than average.

For example, in the commercial mortgage market and commercial property market, we see continued strength in investor demand for major urban markets, particularly the coastal markets in the East Coast and West Coast, but significantly less demand for secondary and tertiary markets in the middle of the country. So large coastal markets appear above average, and secondary and tertiary markets appear below average.

We also have some views by property type. For example, apartments, while they are residential, are rent-generating, so they are included in the commercial mortgage market and the commercial property market. We have seen apartment rental rates grow very rapidly since the financial crisis, as many people have chosen to rent rather than own. We have seen significant building of apartments all across the

country, and in fact, apartments have been the commercial property type where supply has grown at the most rapid pace since the financial crisis. We have some concerns about oversupply in the apartment market. That is a supply problem.

If I shift to a different property type where we think things are a little less good, that would be retail. In retail, the problem is not a function of supply; rather, it is a function of demand. Demand for retail space is somewhat slow because many retailers are suffering from increased competition from internet retail. Because of this dispersion across property markets and property types, we must choose our investments carefully to achieve precisely the exposures we desire.

Those are some of the things that we like and don't like, and that are driving the positioning with individual securities, such as the ones you mentioned. Keep in mind: Valuation is also a part of our process. If fundamentals are weak, but we believe the pricing is very attractive, it is still possible to make significant returns by buying something that is out of favor, provided it is very cheap.

TWST: As you do your asset allocation, are there any trends that you're monitoring very closely, and if so, which ones would they be?

Mr. Antonatos: We are watching inflation expectations and the pace of economic growth in an environment that appears increasingly

procyclical. There may be an opportunity to shift the portfolio more heavily into equities, which tend to have more upside, and lighten up on fixed income. As I mentioned, that is something that we did in December when we added MLPs. We have also more recently been adding some additional equities to the portfolio, and that really is a shift to become a little more procyclical.

TWST: Just overall today, why should a potential investor invest in your closed-end real asset fund as opposed to another like it?

Mr. Antonatos: When you invest in a closed-end fund, one of your principal objectives is income. The fund is currently paying a very attractive distribution yield of approximately 10%. It is a very attractive yield in the form of a monthly distribution of \$0.199 per share. Both of the distribution figures are as of March 2, 2017. But looking through that distribution to the underlying investment strategy, there is also significant appeal in the real asset strategy that we are running here.

When investing in real assets, you are seeking four important potential investment benefits. Number one is portfolio diversification. You want to invest in something that is uncorrelated to other things in your investment portfolio. The second investment benefit is inflation protection. Cash flows from real assets tend to increase with inflation, providing inherent inflation protection. Number three is capital appreciation, which can be achieved in equities but also in fixed income to the extent bonds are trading at discounts to par. The fourth investment benefit of real assets is income.

I want to elaborate briefly about the diversification benefit of investing in real assets. The fund includes three broad asset classes: securitized credit, real asset high yield and real asset equities. For the period 2003 to 2016, securitized credit has historical correlations of 0.4 to global equities and 0.2 to global bonds; real asset high yield has historical correlations of 0.8 to global equities and 0.5 to global bonds; and real asset equities have historical correlations of 0.9 to global equities and 0.5 to global bonds.

TWST: Thank you. (KJL)

LARRY ANTONATOS
Managing Director & Portfolio Manager, Public
Securities Group
Brookfield Asset Management Inc.
Brookfield Place
181 Bay St.
Suite 300
Toronto, ON M5J 2T3
Canada
(416) 363-9491
www.brookfield.com