

# Focus on investments: Australian Retirement Trust's alternative assets investments

February 2023



*Long Beach Container Terminal Australian Retirement Trust Super Savings investment,  
a continuation of Sunsuper's direct investment from 2017 to 2022*



*South Eveleigh Australian Retirement Trust Super Savings investment, a continuation of Sunsuper's direct investment from 2016 to 2022*

# Executive summary

Australian Retirement Trust views the diversification benefits provided by alternative assets as very attractive.

Australian Retirement Trust's ability to maintain higher exposures to alternative asset classes in general, and unlisted assets, in particular, is underpinned by strong, reliable net cashflows into the fund. This largely reflects the fact that our flows are overwhelmingly in the form of compulsory, default superannuation contributions from a membership that is relatively young, and hence much further away from needing to draw down on their investments to fund their retirement.

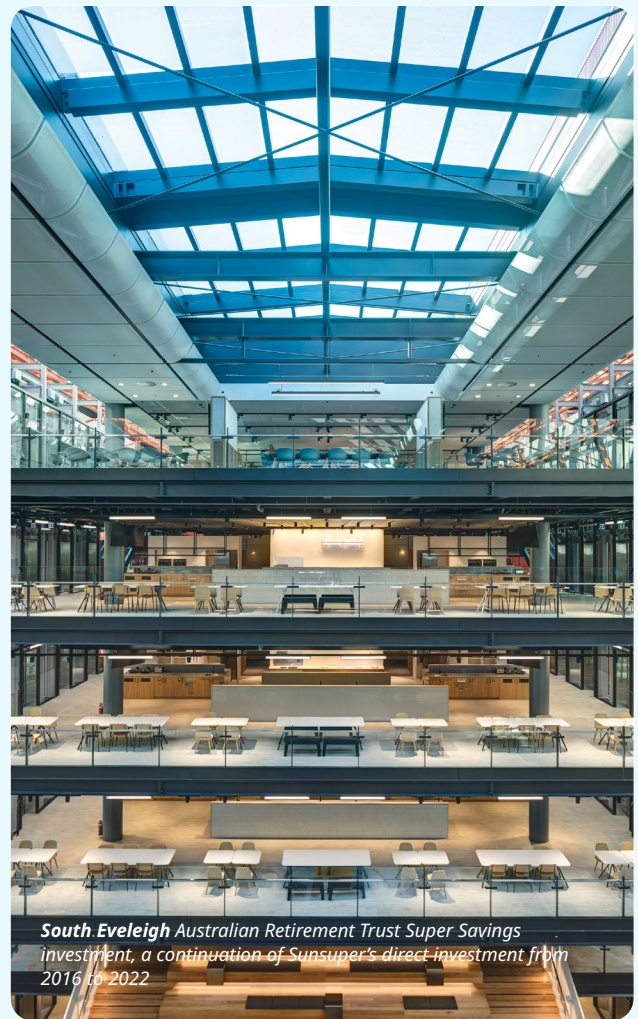
Maintaining substantial allocations to alternative assets allows us to build diversified portfolios that deliver strong long-term real returns, while being less exposed (although certainly not immune) to the short-term volatility of global share markets.

We allocate to four classes of alternative assets: property, infrastructure, private equity and alternative strategies. Alternative strategies include allocations to mezzanine financing and alternative credit strategies, insurance-linked investments and other alternative strategies, which include exposures to both unlisted and publicly traded assets.

Unlike investments in traditional asset classes, such as shares and bonds, which are readily classified as growth and defensive respectively, investments in alternative assets can be more challenging to classify. Even private equity, which Australian Retirement Trust classifies as a growth asset class, displays some defensive characteristics.

Private equity performance tends to be considerably less volatile over time than listed shares, and during major share market downturns, private equity assets tend to experience smaller declines in value.

Returns from both our property and infrastructure investments are expected to be between those of equity and fixed income while being positively correlated to inflation.



- **We allocate to four classes of alternative assets - property, infrastructure, private equity and alternative strategies - to build diversified portfolios that aim to deliver strong long-term real returns.**

From an asset allocation and risk management perspective, neither asset class fits neatly into a growth or defensive category. For the purpose of determining a growth-defensive split within our diversified portfolios, we divide both asset classes equally between growth and defensive. In practice, the returns they deliver, and their behaviour during significant and extended share market declines, are consistent with that assessment.

### What alternative asset classes does Australian Retirement Trust invest in?

For many years, Australian Retirement Trust has held meaningfully higher weightings to alternative assets in our diversified investment options than many of our competitors.

We allocate to four classes of alternative assets: property, infrastructure, private equity and alternative strategies.

We invest with, or alongside, carefully chosen investment managers with acknowledged expertise in the asset class and utilise the advice of specialist consultants where appropriate. Accessing top-tier managers, particularly in private equity and alternative strategies, is critical.

### What's the difference between publicly traded and unlisted asset classes?

Table 1 outlines the differences between publicly traded and unlisted asset classes.

Publicly traded assets	Unlisted assets
Are either listed or quoted on the ASX (or other exchange) or actively traded between market participants (such as investment banks and institutional investors).	Are not quoted on any exchange and cannot be traded at any time.
Valued daily.	Valued less frequently. Usually quarterly, semi-annually and annually.
Subject to significant volatility driven by perceptions of the underlying security and general market sentiment.	Significantly less volatile as the assets are less likely to be influenced by market sentiment.
Highly liquid.	Low liquidity.

Table 1: Differences between publicly traded and unlisted asset classes



### Why do we invest in alternative asset classes?

The short answer is because we can. Our ability to hold higher allocations to alternative asset classes, particularly unlisted assets, reflects our strong reliable cash inflows, from a relatively young membership making compulsory superannuation contributions.

Moreover, as one of the world's largest asset owners, with assets well in excess of A\$200 billion, we are able to build well-diversified portfolios in the alternative asset classes. In general, we expect our alternative asset classes to deliver attractive long-term returns for members, while reducing their exposure to share market volatility.

It is imperative that any decision to allocate to alternative assets be assessed against the Fund's overall liquidity requirements, and the need for member equity – the need to provide fair daily unit prices for all our investment options, so that any member buying or selling units on any given day is treated fairly.

Our unlisted assets are expected to deliver long-term returns that more than compensate for the illiquid nature of the assets and the costs incurred in managing these assets.

In the case of alternative strategies, we expect returns in excess of traditional asset classes after fees, with low volatility consistent with other defensive assets and a low correlation to share and bond markets.

## Property

Australian Retirement Trust's property portfolio invests in a range of institutional-quality property assets, both within Australia and globally. Institutional-quality property investments typically include office buildings, retail centres and industrial warehouses but can also include residential, hotels, retirement villages, healthcare, education, leisure, self-storage, data centres and land.

In addition to investments in property – both directly and via institutional funds – we also invest in property-backed debt securities, in the US, the UK and Europe.

Under normal market conditions, the property portfolio will seek to provide returns between that of listed shares and fixed income that are also positively correlated to inflation. Returns from the unlisted property portfolio are expected to be largely from rental income rather than capital gains.

We invest in property developments only when the risk-adjusted returns are favourable given our preference has been to invest into established properties with a reliable rental income stream. One notable example – our decision in 2016 to invest alongside Mirvac and AMP in the South Eveleigh office development in South Sydney – reflects the involvement of the Commonwealth Bank as the long-term anchor tenant underpinning the development and therefore reducing the development risk.

Australian Retirement Trust's largest property exposures are outlined in table 2.

Asset	Carrying value March 2022 (A\$)	Sector	Geography
Discovery Parks	>\$900m	Other	Australia
Goodman Australia Industrial Partnership	>\$600m	Industrial	Australia
Sunstone	>\$500m	Diversified	Various
Sunbridge	>\$400m	Diversified	North America

Berkshire Bridge Loan II	>\$300m	Residential	North America
South Eveleigh, NSW	>\$300m	Office	Australia
AMP Capital Shopping Centre Fund	>\$300m	Retail	Australia
GPT Wholesale Office Fund	>\$200m	Office	Australia
Berkshire Value Fund V - Coinvest	>\$200m	Residential	North America
Hulk Logistics Coinvestment	>\$200m	Industrial	Asia
Other	>\$3,000m	Various	Various
<b>TOTAL</b>	<b>~A\$7,600m</b>		

Table 2: Australian Retirement Trust's largest property exposures at March 2022.

## Infrastructure

Infrastructure refers to the fundamental assets of a society that are required to provide essential services to its population and are accessible to or used directly or indirectly by a large number of people. As with our property investments, the aim of infrastructure investments in our investment portfolios is to provide returns between those of listed shares and fixed income while being positively correlated to inflation.

Infrastructure investments are typically characterised by several of the following key features: long duration, large initial capital outlays, monopolistic qualities, stable income, GDP or inflation-linked earnings, and returns dominated by income, once an asset has matured.

Institutional-quality infrastructure typically includes airports, ports, roads, railways, registries, utilities, water treatment plants and digital infrastructure assets, in addition to assets operating in the renewable energy sector and through public-private partnerships with government agencies.

Australian Retirement Trust's largest infrastructure exposures are outlined in table 3.

Asset	Carrying value Dec 2022 (A\$)	Sector	Geography
Ausnet	>\$1b	Utilities	Australia
Puget	>\$700m	Utilities	USA
VicRoads	>\$600m	Registries	Australia
Brisbane Airport	>\$600m	Airports	Australia
Macquarie Infrastructure Partners IV	>\$500m	Diversified	North & South America
Bristol & Birmingham Airports	>\$500m	Airports	Europe
Macquarie Air Finance	>\$500m	Aircraft Leasing	Global
MCO Infrastructure Partnership	>\$400m	Diversified	Global
The Infrastructure Fund	>\$400m	Diversified	Australia
Macquarie Infrastructure Partners V	>\$400m	Diversified	North America
Arlanda Express	>\$200m	Rail	Europe
Other	>\$4b		
<b>TOTAL</b>	<b>~\$11,500m</b>		

Table 3: Australian Retirement Trust's largest infrastructure exposures at December 2022.

## Private equity

Our private equity portfolio invests in some debt but mostly unlisted equity investments across the globe. We expect to extract an illiquidity return premium relative to listed share markets. Investing via various forms of private ownership provides us with the ability

to take advantage of time and control, and to access relatively inefficient markets, generally in small and midcap companies.

Private equity provides access to the largest pool of companies in the world and enhances the diversification of the portfolio. For example, private companies account for over 85 per cent of US firms with 500 or more employees.

Australian Retirement Trust's private equity portfolio is primarily invested with 20 to 30 carefully chosen managers across the key sub-sectors of the asset class as defined below: buyout, venture capital, growth equity, special situations and distressed debt.

Sector	
Buyout	Transactions where a manager purchases control or a substantial minority of a company and often a large percentage of the purchase price is financed through leverage.
Venture capital	Investments in early-stage, high-potential, high-risk, growth start-up companies in high technology industries, such as biotechnology, IT, etc.
Growth equity	Providing capital to later-stage companies to facilitate transformational growth through expanding operations, entering new markets, or strategic acquisitions.
Special situations	Opportunistic short-term private, public or distressed investment where a short-term catalyst is expected to provide upside to an investment's valuation.
Distressed debt	Purchases of debt obligations trading at a discount to par value in anticipation of either taking control of the underlying assets/company or reselling the debt securities at a higher level.

**Partnering with high-quality managers in private equity is critical, as the difference in performance between top and bottom quartile managers can be vast.**

Performance tends to be more persistent than in traditional asset classes, as private capital managers who perform strongly tend to attract higher quality deal flow, which in turn drives future performance.

The largest manager exposures in Australian Retirement Trust's private equity portfolio are shown in table 4.

Manager	Sector
Harbourvest	Buyout/Co-investments
Neuberger Berman	Buyout/Co-investments
StepStone	Buyout/Co-investments
Vista	Buyout
Genster	Buyout
Waud	Buyout
Unigestion	Buyout/Co-investments
Baring PE Asia	Buyout
Pacific Alliance Group	Buyout / Special Sits
Other managers	Various

**Table 4:** Largest manager exposures in Australian Retirement Trust's private equity portfolio.

The portfolio either directly or indirectly invests in over 2,000 companies. While we do invest in managers' funds, we also seek to co-invest alongside our preferred managers. This allows us to lower costs and gain greater transparency and control over our private equity investments.

The top 10 company exposures in Australian Retirement Trust's private equity portfolio are shown in table 5.

Top 10 company exposures	Sector
AutoStore	Industrials
Integrated Practice Solutions	Healthcare
Visma	Information Technology
TIBCO	Information Technology
Preston Hollow	Financials
InterlIHUB	Utilities
LeasePlan	Financials
Perimeter Solutions	Industrials
Signant Health	Healthcare
Solera	Information Technology

**Table 5:** Top 10 company exposures in Australian Retirement Trust's private equity portfolio

### Alternative strategies

The alternative strategies asset class is a portfolio that focuses on private and alternative credit and seeks to capture opportunities that may not fit neatly into the other major asset class categories.



**Arlanda Express** Australian Retirement Trust Super Savings investment, a continuation of Sunsuper's direct investment from 2014 to 2022

It is globally diversified, with flexibility to opportunistically invest in public and private markets. It employs an opportunistic and bottom-up approach, taking advantage of market dislocations where our capital can earn outsized returns

The aim of alternative strategies investments in our investment options is to produce consistent absolute returns that help diversify our public market long-only exposures. The alternative strategies portfolio generates its returns largely from defensive assets and strategies but includes some equity-like return sources (coupled with a return premium for illiquidity). The portfolio is designed to have lower volatility than equities and bonds while producing returns that have a low correlation to the performance of those asset classes.

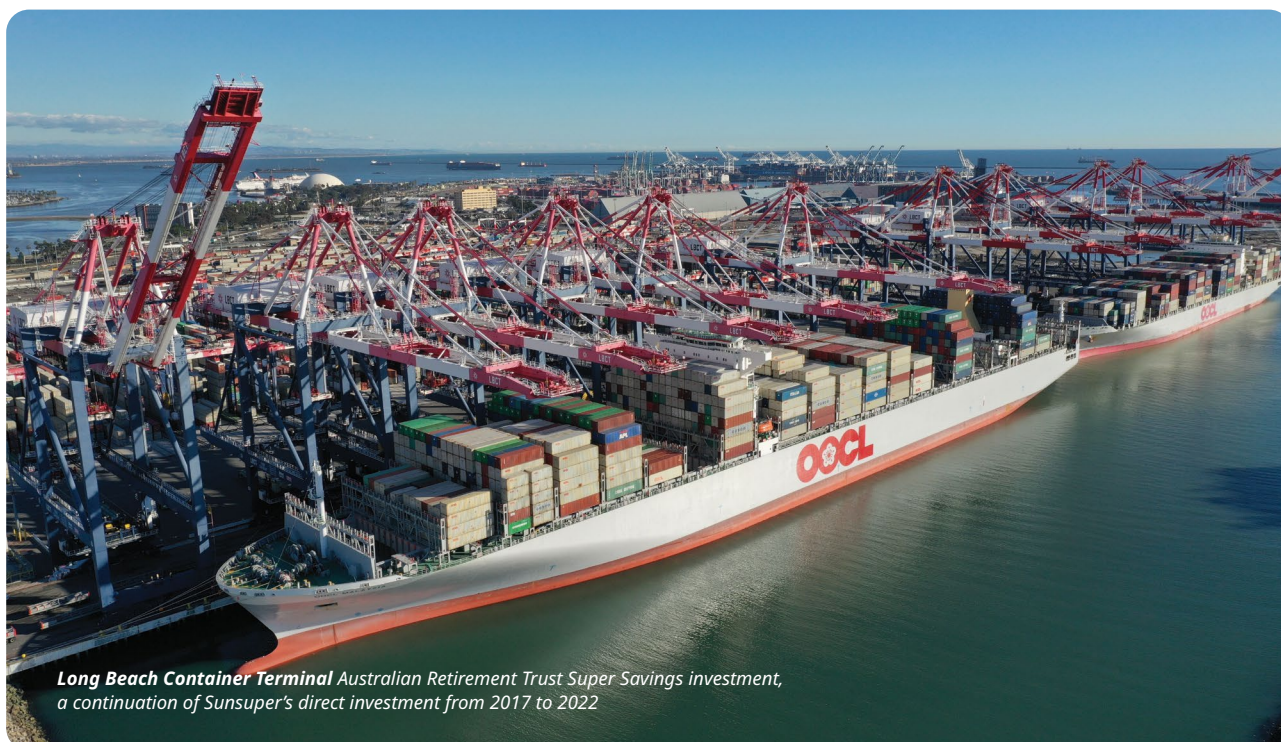
In recent years, we have focused on bank replacement credit in asset-backed sectors such as real estate and energy and acquiring mid-risk assets in sectors such as agriculture and insurance. We have also historically been active in non-traditional insurance strategies and invested in event-driven opportunities such as liquidations and trade claims, as well as both equity and credit arbitrage.

Australian Retirement Trust's alternative strategies portfolio is primarily invested with 10 to 15 carefully chosen managers. While we do invest in managers' funds, we increasingly seek to co-invest alongside our preferred managers.

This allows us to lower costs and gain greater transparency and control over our investments. The top manager exposures in Australian Retirement Trust's alternative strategies portfolio are shown in table 6.

Manager	Sector
Stepstone	Opportunistic
Blackrock	Specialist Credit
PAG	Specialist Credit
EIG	Specialist Credit
Hayfin	Specialist Credit
Taconic	Specialist Credit
Varde	Specialist Credit
SC Lowy	Specialist Credit
Neuberger Berman	Specialist Credit
Resolution Life	Opportunistic

*Table 6: Top manager exposures in Australian Retirement Trust's alternative strategies portfolio.*





## Growth vs defensive

The level of growth assets is a key differentiator between investment strategies, and it is a regularly used metric when determining the appropriate investment strategy for an investor.

Growth assets are typically characterised by higher long-term expected returns but with higher volatility or variability in returns in the short term. Growth assets typically display pro-cyclical behaviour with strong performance when economic conditions are improving.

In contrast, defensive assets are characterised by lower long-term returns but with lower volatility, delivering a more stable return pattern. Defensive assets are not generally linked with the economic cycle, and they can, in certain situations, produce their strongest performance when growth assets are suffering.

Our investments in traditional asset classes, shares and bonds, are readily classified as growth and defensive respectively. Characterising unlisted assets, however, can be more challenging. Even in the case of private equity, which Australian Retirement Trust characterises as a purely growth asset class, performance tends to be considerably less volatile over time than listed shares, and, even during major share market declines, private equity assets tend to experience less severe downturns.

Under normal market conditions, the property portfolio will seek to provide returns between those of listed shares and fixed income that are also positively correlated to inflation. Returns from the unlisted property portfolio are largely rental income rather than capital gains.

As with our property investments, the aim of infrastructure investments in our investment portfolios is to provide returns between those of shares and fixed income while being positively correlated to inflation. Returns, however, tend to be tilted more towards capital gains than income.

From an asset allocation and risk management perspective, neither asset class (property or infrastructure) fits neatly into a growth or defensive category. Both asset classes capture returns generated by a growing economy, and yet a significant proportion of the returns over time are likely to come from relatively stable income streams. For the purpose of determining a growth-defensive split within our diversified portfolios, we divide both asset classes equally between growth and defensive.

In practice, the returns they deliver, and their behaviour during significant and extended share market declines, are entirely consistent with that assessment.

Moreover, both portfolios are deliberately structured to be significantly more defensive than either listed real estate investment trusts (REITs) or listed infrastructure vehicles.

Historically, we have characterised our alternative strategies portfolio as 100 per cent defensive. However, the portfolio has evolved considerably over recent years and now comprises largely defensive assets and strategies, together with some mid-risk and equity-like investments. As a result, we now classify this portfolio as 75 per cent defensive and 25 per cent growth, and expect it to have a lower volatility than, and a very low correlation to, the performance of global capital markets.

Just how valid is our approach to categorising asset classes as either growth or defensive? We would expect private equity returns to be more systematically related to share market performance than either unlisted property or infrastructure. In turn, we expect our alternative strategies portfolio to be even less systematically related to share market returns. We use the concept of portfolio Beta to test how systematically related each of our alternative asset classes are to the performance of share markets.

In order to prevent artificially understating the extent of the relationship, we allow for the valuation lag between the performance of share markets and the valuation of our alternative assets.

Table 7 summarises the percentage growth exposure we assign to each asset class to the actual growth exposure as determined by the relationship between Australian Retirement Trust's alternative asset class returns with those of listed share markets.

	Growth	Estimated valuation lag (months)*	Estimated Beta**
Property	50	9	0.35
Infrastructure	50	9	0.35
Private Capital	100	6	0.50
Alternative Strategies	25	6	0.25

**Table 7:** Percentage growth exposure of Australian Retirement Trust's alternative asset classes. \*Estimated valuation lag from regression analysis of rolling 1-year returns. \*\*Estimated Beta after allowing for valuation lag. Beta measures the responsiveness of asset class returns to those of share markets, e.g. a Beta of 0.49 implies that a 1% gain in share markets would be associated with a 0.49% gain in for the asset class in question. Calculations based on Sunsuper unlisted asset returns and the returns of an equally weighted index of Australian (S&P/ASX300) and developed market (MSCI World hedged into A\$) equities.

## How do alternative asset classes fare during major market downturns?

Another way of assessing the validity of our growth versus defensive categorisation is by examining the behaviour of alternative asset classes during periods of share market weakness.

During periods of sharply weaker share prices, such as the March and June quarters of 2022, Australian Retirement Trust's diversified investment options tend to perform very favourably against our peers, as unlisted asset valuations do not respond to short-term changes in market sentiment.

In the event of a more severe share market and economic downturn, such as the one experienced during the early stages of the COVID-19 lockdowns in March 2020, unlisted asset valuations are inevitably impacted.

Just how much of a decline in value our unlisted assets experience depends on both the depth and duration of the share market downturn and the impact on the broader economy.

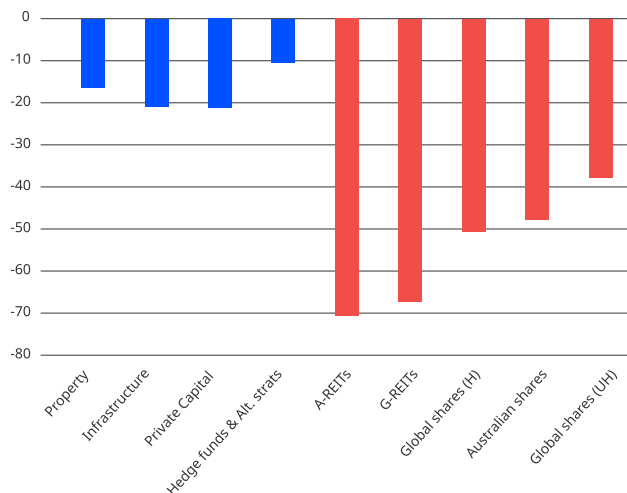
When weaker share markets are followed by a recession, then virtually all growth assets – listed and unlisted – and assets with even moderate growth characteristics are likely to fall in value.

However, unlisted assets, particularly property and infrastructure assets, are more defensive and have historically not declined as much in value as listed shares in such an environment: a result which has typically led to Australian Retirement Trust outperforming our peers, particularly our retail competitors, during market downturns.

The Global Financial Crisis and COVID-19 lockdowns were perhaps the most powerful "stress test" of this approach. Charts 1 and 2 show the peak-to-trough performance of the key publicly traded growth asset classes against Australian Retirement Trust's alternative asset portfolios during the GFC and COVID-19 respectively.

## Just how defensive are unlisted assets likely to be?

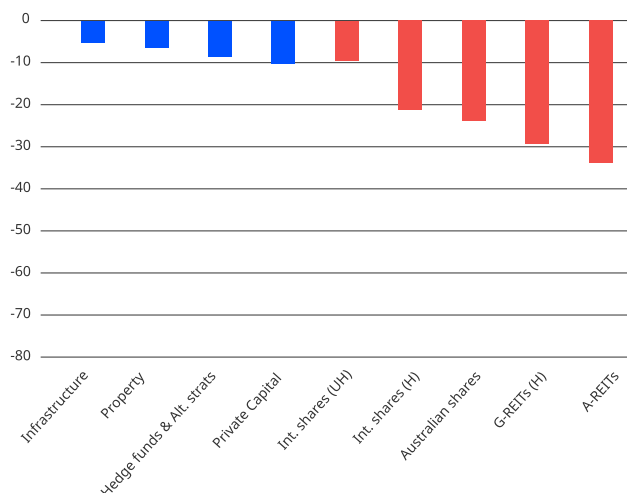
### Maximum drawdown\* during GFC



**Chart 1:** Peak to trough performance of key publicly traded growth asset classes against Australian Retirement Trust's alternative asset portfolios during the GFC.

Sources: Australian Retirement Trust, Refinitiv. Data for alternative asset classes: Sunsuper portfolio performance. Data for public markets: Australian REITs - S&P/ASX300 A-REIT Accumulation Index; Global REITs - FTSE/EPRA NAREIT Index hedged into A\$; Australian shares - S&P/ASX300 Accumulation Index; International shares - MSCI World Indices. \*Dates for drawdown calculations vary between asset classes.

### COVID-19 drawdown



### March quarter 2020 return (%)

**Chart 2:** Peak to trough performance of key publicly traded growth asset classes against Australian Retirement Trust's alternative asset portfolios during COVID-19.

Sources: Australian Retirement Trust, Refinitiv.

The results for the GFC period are adjusted for the lag between share market declines and the timing of alternative asset valuations. However, for the COVID-19 example, the returns are contemporaneous.

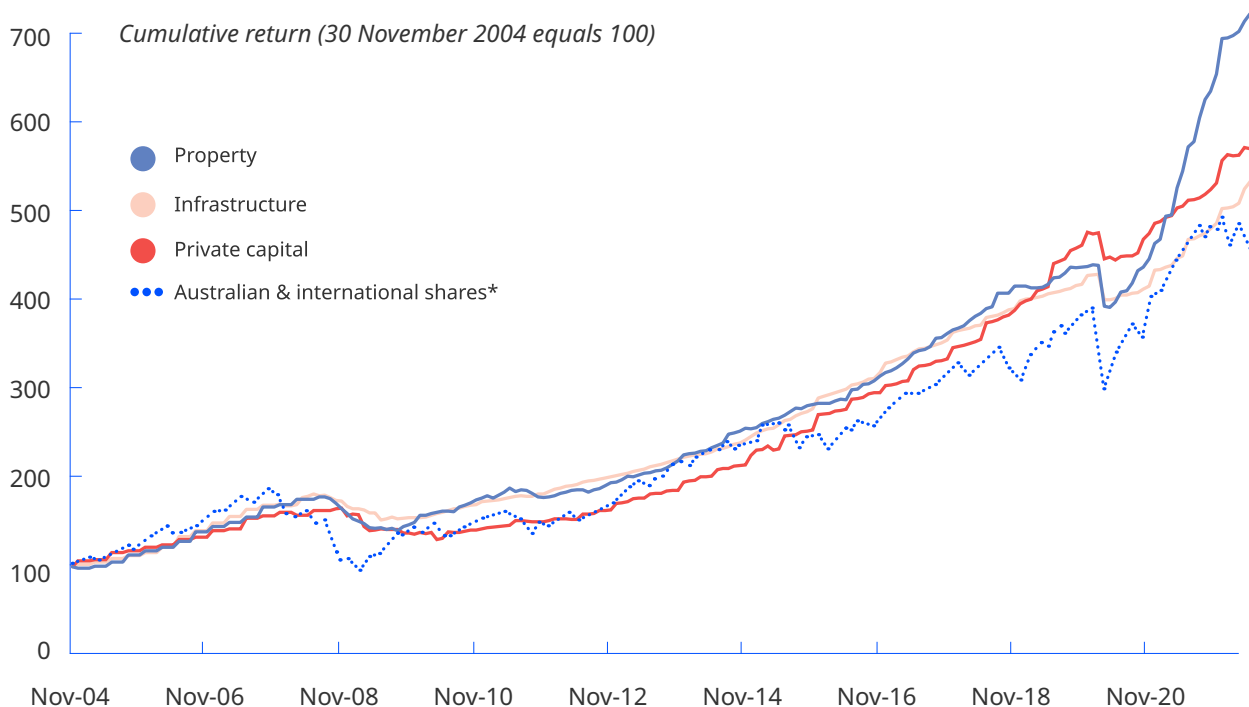
This reflects the extraordinary nature of the COVID financial crisis: the lag between the declines in world share markets and the downward adjustments in unlisted asset valuations was very short – a matter of days to several weeks rather than months, and all occurred during the March quarter of 2020.

● **While alternative assets were far from immune to the crises, they nevertheless demonstrated significant defensive characteristics.** ●

## Conclusion: solid net returns with reduced volatility

### Strategic diversification via alternative assets

Long term performance of alternative assets



**Chart 3:** Total returns from Australian Retirement Trust's alternative asset classes against an index of Australian and international shares.

Sources: Refinitiv, Australian Retirement Trust. \*Total return index comprising 50% MSCI hedged in A\$ and 50% S&P/ASX300 Accumulation Index. Last observation is March 2022.

Chart 3 displays the total returns from Australian Retirement Trust's alternative asset classes against an index of Australian and international shares since November 2004.

By holding a substantial allocation to alternative assets, we aim to deliver strong long-term returns – in particular, by capturing the illiquidity premium attached to unlisted assets – while reducing the short-term volatility our members face by investing in share markets.

Australian Retirement Trust's three unlisted asset classes have delivered on those objectives. Our alternative strategies portfolio has delivered solid net returns above cash, while acting as an important diversifier during difficult share market conditions.



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