

## QUARTERLY REAL ASSETS NEWSLETTER

### Real Assets

Altius has seen a meaningful increase in interest in real assets throughout 2011. Inflation has begun to increase - not only in Emerging Markets but in the US, Europe, and Canada. While it is not yet apparent if inflation will become systemic and have a negative impact on the global economy, many investors have decided that it is prudent to incorporate inflation sensitive investments into their portfolio to prepare in the event inflation becomes an issue.

### Inflation

Producer prices in the United States rose 0.8% in September, their fastest pace in five months. This equates to a 10% annualized wholesale inflation rate. On an unadjusted basis, producer prices climbed 6.9% for the 12 months ended September 2011. Consumer prices rose a more moderate 0.3% or 3.7% annualized. The trailing 12-month rate was 3.9%.

Producer prices in the 17-nation euro region rose 5.8% in September from a year earlier. The Euro-area annual inflation rate at the consumer level was 3.0% in September 2011, up sharply from just 1.9% one year earlier.

High and rising inflation will complicate the efforts of both the Federal Reserve and the European Central Bank to bolster weak and faltering economies.

So it's no longer a question of when inflation will return—it already has. The question smart investors are now asking is, "How high will it go?" We can't answer that, but we can create a strong portfolio of inflation hedges—real assets—that should perform extremely well in an inflationary environment.

### Energy

Henry Hub natural gas spot prices traded in a range between USD3.68 and USD4.64 during the quarter. Prices were typically three times higher in Europe. West Texas Intermediate oil (the US benchmark) spent most of the third quarter in the USD80-100 range, while Brent crude (the European benchmark) generally ranged between USD100-120.

The shale boom has crossed the ocean and is now making news in Europe, which likely possesses large reserves of unconventional gas. A shale gas discovery of up to 200 trillion cubic feet was reported in northwest UK, where commercial production could begin as soon as 2013.

But the biggest energy story in the third quarter was the high profile bankruptcy of solar company Solyndra, despite receiving a half billion dollar loan guarantee from the US government.

I think Brad Jones of Redpoint Ventures got it just about right in a 2009 email (as reported in *The Wall Street Journal*): "The allocation of spending to clean energy is haphazard; the government is just not well equipped to decide which companies should get the money and how much... One of our solar companies with revenues of less than \$100 million (and not yet profitable) received a government loan of \$580 million; while that is good for us, I can't imagine it's a good way for the government to use taxpayer money."

## Infrastructure

Private market infrastructure investment opportunities continue to arise and expand all over the world. Some recent examples:

- A proposed 2.7-mile toll bridge linking Anchorage, Alaska to Port Mackenzie
- Madrid and Barcelona airports
- Ohio University parking
- Luis Muñoz Marín International Airport in Puerto Rico
- An expanded highway lane system throughout Atlanta
- A bridge to connect Kentucky and southern Indiana
- Istanbul's two suspension bridges

In the US, Representative John Mica, chairman of the House Transportation and Infrastructure Committee, introduced a bill that, according to the Committee's website will remove "current barriers that prevent the private sector from offering public transportation services." And so the US continues to move slowly, but surely, towards catching up with the rest of the world.

The UK government is seeking to deliver £1.5 billion of savings from nearly 500 Private Finance Initiative ("PFI") projects in England. This amounts to savings of around 5% of annual payments. Three areas for savings include: 1) effective management of contracts (e.g. reducing energy consumption); 2) efficient use of space (e.g. sub-leasing empty space); and 3) reviewing soft service requirements (e.g. window cleaning). "We are determined to reform PFI contracts to protect the taxpayer," said UK chancellor George Osborne. In July, the UK's Public Accounts Committee challenged the heads of infrastructure funds Innisfree and Semperian about whether private funds would accept retroactive cuts to contractually agreed returns (shades of Spain?). Such an action was rejected by the fund managers, although they hinted they might be open to sharing profits from the sale of projects.



## Timber

US timberland prices, as measured by the NCREIF Timberland Index, dropped 0.4% in the third quarter of 2011, but are still slightly positive for the year to date. Prices should continue to rise steadily but slowly until we see stronger economic growth and/or higher inflation.

Market activity has not increased as expected. Despite a flurry of sales in the first four months of 2011, annual transaction volume now looks likely to remain modest—as it was in 2010. There has been no flood of capital into timber managers (thereby reducing demand) and most owners are in no hurry to sell (thus reducing supply).

In the first half of 2011, log export volume from New Zealand increased by 27%—and revenues by 39%—compared to the prior year. China, Japan, South Korea, Taiwan, and India are New Zealand's five largest export markets. New Zealand is one of the non-US markets that Altius has been recommending for the past three years.



## Field Trip

Altius Partner Jay Yoder recently spent time touring an ArborGen property in South Carolina. ArborGen is a leader in the “development and commercialization of technologies that produce purpose grown trees.” Basically, they produce better seedlings—most of which are utilized by timber managers and the timber industry. One method ArborGen utilizes is controlled pollination — think of it as artificial insemination for plants — thereby determining both the “father” and “mother” of a seedling. They accomplish this by securing a paper bag around a tree’s flowers to prevent access by free-floating pollen. ArborGen then collects pollen from desirable trees and injects it into the paper bags. The bags are removed when the flowers close up and you have a seedling with two known “parents.” As you might imagine, this is a very labor-intensive process.

Jay was able to tour test plots containing the 10 year old offspring of this process and reports that the improvement over “normal” trees was noticeably visible—straighter growth, fewer forks, fewer and smaller limbs, and, he was told, faster growth. Trees are also bred for other traits — disease resistance, stress tolerance, and wood quality, for example. Jay also viewed a small plot of genetically identical trees, all cloned from the same seed. These were of the highest quality, but as you might expect, far more expensive to produce.

One doesn’t often think of technology when thinking of forestry, but amazing innovations and advances are occurring—with the potential to enhance growth, create more valuable trees, and boost returns to investors.

## Recent News from Altius Associates

Altius Associates is pleased to announce two new mandates. Altius will assist the Overseas Private Investment Corporation (“OPIC”), a US government development finance institution, in its recently issued \$400 million call for proposals from private equity funds specializing in equity, debt, mezzanine, fund of funds and hybrid fund strategies in emerging markets. Altius has worked with OPIC since 2009.

Additionally, Altius Associates was recently hired by the Kentucky Retirement System (“KRS”) to serve as their private equity consultant. Altius will work with KRS on a global basis as they continue to build and develop their private equity program.

## About Altius

Altius Associates helps institutional investors access the many benefits of private real assets, including energy, timber, and infrastructure. If you have any questions or would like more information, please contact:

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