

AVIVA INVESTORS

QUARTERLY UPDATE ON DRIVERS IN ILLIQUID ASSETS Q4 2018



In our regular update on real assets:

- We check recent trends in UK property and infrastructure equity in a period of Brexit-related uncertainty; and
- Illustrate the spreads achievable across private assets of varying credit quality.

Key themes:

Real estate: demand for prime assets forces yields to record lows

REAL ESTATE: DEMAND FOR PRIME ASSETS FORCES YIELDS TOWARDS RECORD LOWS

In liquid markets, volatility is up from its recent ultra-low base. The return of global inflation and prospect of tighter monetary policy across the world, trade tensions, Brexit unknowns and concerns about corporate earnings have all played a part.

Real estate tends to display relatively low volatility compared with liquid assets (highlighted in the chart overleaf). Although the unexpected outcome of the Brexit vote in 2016 caused a volatility spike, it has now fallen back to the longer-term trend. We expect the return of volatility to impact real estate and other real assets, but with a lag.

Meanwhile, the search for yield continues to drive activity. Demand for prime assets has forced yields to record lows in most office and logistics markets, and the premium for investing in secondary assets or peripheral locations has been shrinking as well. Trends in the retail sector differ somewhat, with investors increasingly acting with caution as structural challenges become more apparent.

Investors positioning for the next stage of the cycle should look to limit exposure to riskier forms of real estate and focus on core product with defensive qualities.

Infrastructure equity: strong investment demand continues

INFRASTRUCTURE EQUITY: STRONG DEMAND CONTINUES FOLLOWING RECORD FUND RAISING

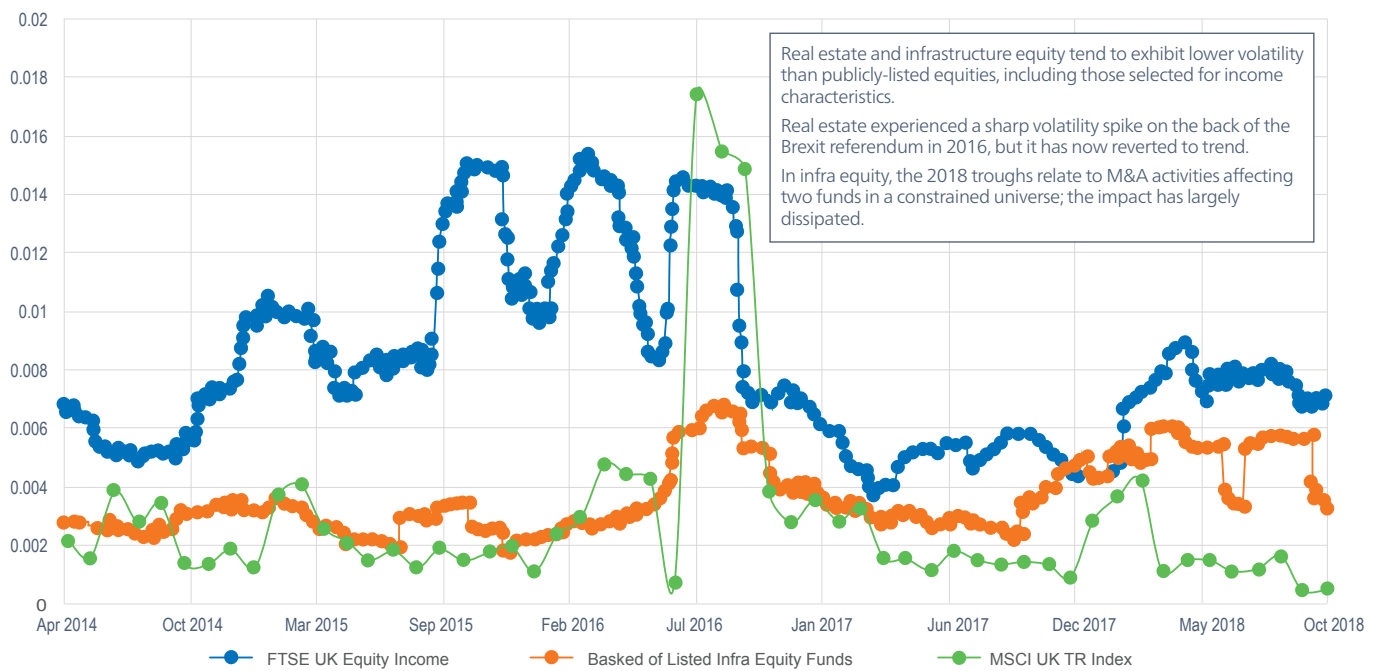
In volatile times, we see strong interest in infrastructure equity, as the provision of essential services continues to be relatively decorrelated from economic fluctuations. Assets with scope for income growth and/or inflation protection are of particular interest in a rising rates environment.

There has been record fundraising in European-focused infrastructure of \$32.2 billion in the year-to-date, according to Preqin. Renewables and higher yielding sectors such as full fibre broadband have been hotspots of activity. Interest in the latter has been driven by the digital agenda across Europe, including the UK government's objective to connect 15 million households by 2025.

Against this backdrop, infra equity has shown lower volatility than public equity comparators. That includes broad market indices like the FTSE 100, as well as the dividend paying stocks represented in the FTSE Equity Income Index that are often followed for their more defensive characteristics.

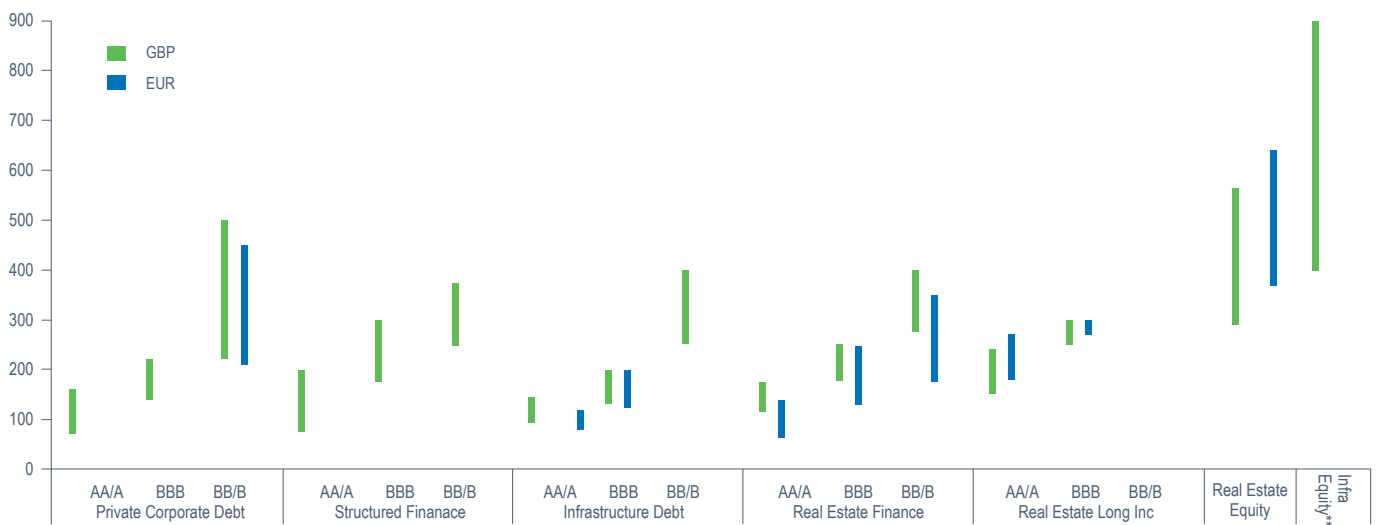
Nevertheless, it is important to note the idiosyncratic nature of infrastructure investments, and the nature of risk. For example, the UK government recently decided to phase out subsidies for small-scale solar by 2019, changing the revenue dynamics. In Europe, the trajectory of the renewables market is also shifting towards a subsidy-free environment.

Comparing quarterly rolling volatility of select liquid and illiquid assets



Infrastructure equity: Cumulative return of basket of funds including HICL Infrastructure Company Ltd., International Public Partnerships Ltd., 3I Infrastructure plc, GCP Infrastructure Investments Ltd., John Laing Infrastructure Fund, Foresight Solar Fund Limited, The Renewables Infrastructure Group Ltd, Bluefield Solar Income Fund Ltd, NextEnergy Solar Fund Limited, Greencoat U.K. Wind plc, John Laing Environmental Assets Group Ltd, weighted by fund size. Source: Bloomberg, as at 5 November 2018

Indicative spreads p.a.*



* Additional yield above comparable government bonds **High quality: unlevered infrastructure with largely predictable cash flow. Source: Aviva Investors (for illustrative purposes only). All data as at 30 September 2018. The future returns and opinions expressed are based on Aviva Investors internal forecasts and should not be relied upon as indicating any guarantee of return from an investment managed by Aviva Investors nor as advice of any nature.

RISKS

ILLIQUIDITY: Alternative Income assets are significantly less liquid than assets traded on public markets. Where funds are invested in infrastructure/real estate, investors may not be able to switch or cash in an investment when they want because infrastructure may not always be readily saleable. If this is the case, we may defer a request to redeem the investment.

VALUATION: Investors should bear in mind that the valuation of real estate/infrastructure is generally a matter of valuers' opinion rather than fact. The value of an investment and any income from it may go down as well as up and the investor may not get back the original amount invested. Past performance is not a guide to future returns. The value of an investment and any income from it may go down as well as up and the investor may not get back the original amount invested. Past performance is not a guide to future returns.

Important information

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