19th November 2021

Liquid Real Asset performance update

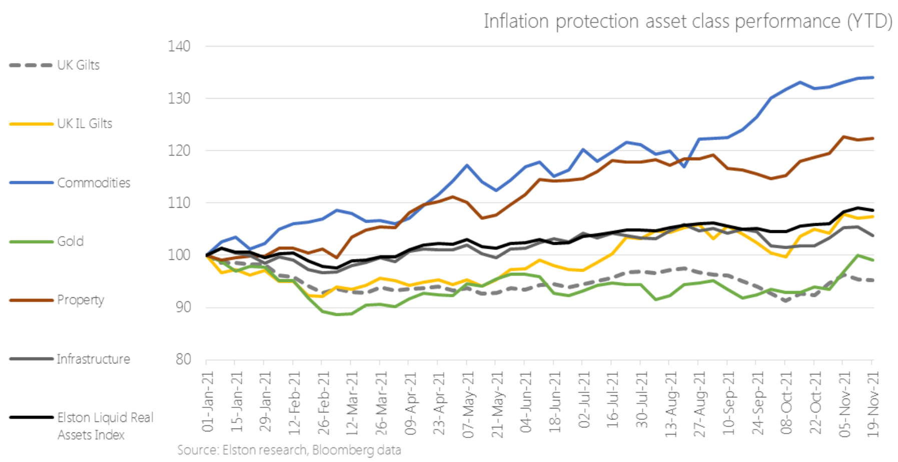
- Inflation is on the rise
- Delivering real asset exposure, with bond-like volatility
- Real assets have the potential to keep ahead of inflation

Inflation on the rise

With inflation on the rise – and potentially interest rates too – nominal bonds are likely to remain under pressure. Whilst "real assets" – such as property, infrastructure and gold – have potential to preserve value in inflationary regimes, how can a switch from bonds to real assets be made without materially up-risking portfolios? This was the challenge we addressed in the design of our Liquid Real Assets index.

Our Liquid Real Assets Index was developed to combine exposure to higher risk-return real asset exposures, with lower risk-return interest rate-sensitive assets, to deliver a real asset return exposure for inflation protection, in liquid format, with bond-like volatility to keep risk budgets in check. Given the rising inflationary pressures both in the US (where in Oct-21 it crossed 6%, the highest level in 30 years) and in the UK (where in Oct-21 it crossed 4%, the highest level in a decade), we take stock on the index performance year-to-date and are glad to say it's "doing what it says on the tin.

Fig.1. Elston Liquid Real Assets Index YTD performance



The chart above shows the year-to-date performance of some of the key components of the Liquid Real Assets Index, as well as the index overall, relative to UK Gilts.

The objective is not to maximise returns within the real assets sector, but to deliver a return premium to gilts, with gilt-like volatility. In this respect, the index is on track.

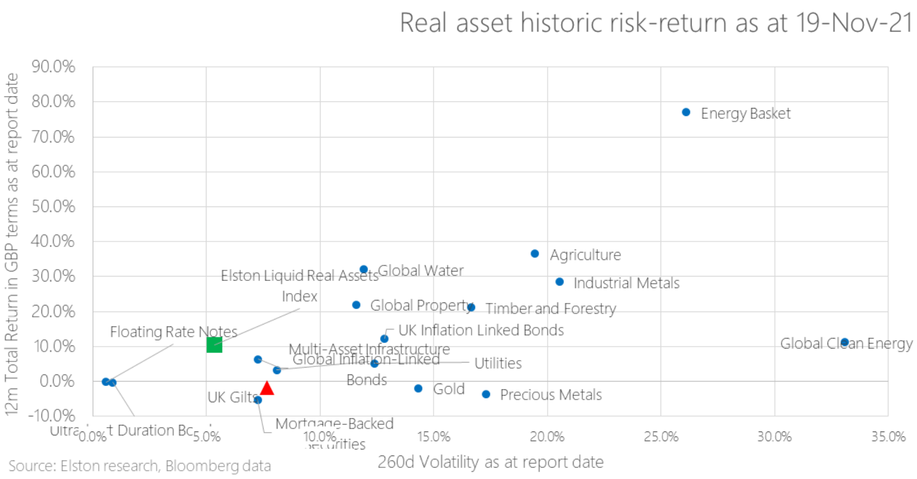
In aggregate, the index has returned +8.63% YTD, compared to -4.11% for UK gilts (in GBP terms on a total returns basis).

Delivering real asset exposure, with bond-like volatility

Over the last 12 months the index has returned +10.4%yy (in GBP terms) with a volatility of 5.3% (green square in Fig.2.), compared to -2.7%yy for UK Gilts, with a volatility 7.7% (red triangle in Fig.2.).

This is a result of the pairing of higher risk-return real asset exposures, with lower risk-return rate-sensitive assets which have the potential to deliver returns in a rising interest rate environment.

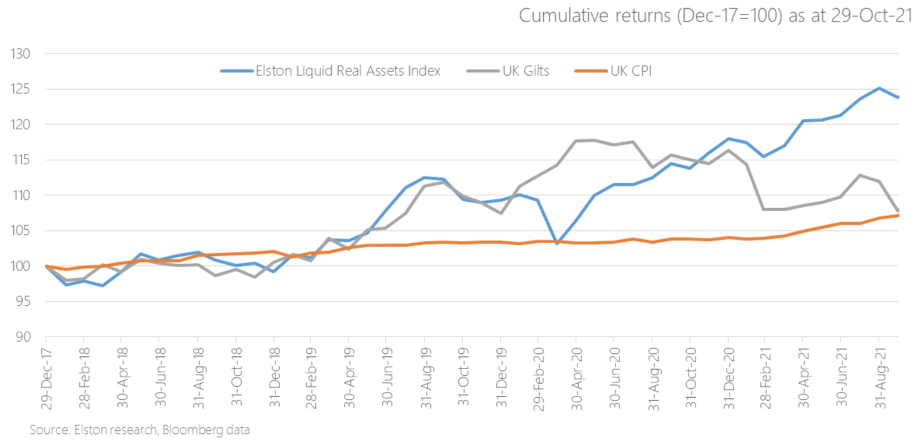
Fig.2. Real asset risk-return: index and components



Relative to inflation

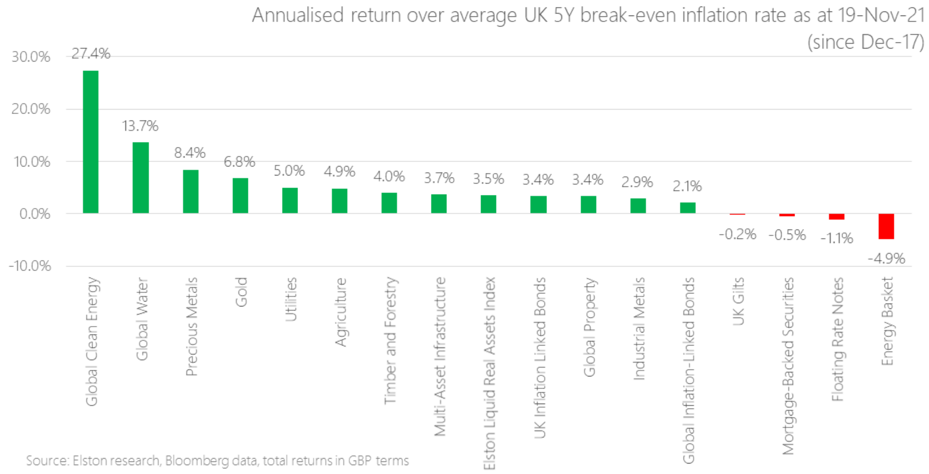
Looking at the longer-term history since index inception (Dec-17), the Elston Liquid Real Assets index has delivered returns in excess of inflation, whilst UK Gilts have matched inflation. Gilts ability to keep pace with inflation may be diminished as inflation increases and interest rates potentially rise.

Fig.3. Performance relative to inflation



In addition to performance relative to headline CPI, we also look at real asset returns relative to average 5 year inflation break-even rates. Against this measure, the index has delivered a 3.5%p.a. premium to, compared to a -0.2%p.a. discount for UK Gilts.

Fig.4. Premium relative to 5 year break-even rates



Summary

Our Liquid Real Assets Index is designed to deliver a real asset return exposure, with bond-like volatility.

We are satisfied that it is performing in a way that is consistent with its design expectations.

Henry Cobbe

Elston Consulting

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