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CAPITAL PARTNERS

WHY INVEST IN AGRICULTURE?

The emergence of agriculture as an institutional grade asset class presents new opportunities for investors globally.

EXECUTIVE SUMMARY

- This paper is part one of a series of discussion papers that looks at Agriculture's emergence as an institutional asset class, it's fit within portfolio's and historical resilience to economic shocks. As the impacts of COVID-19 become more apparent the series will review how the sector has fared.
- Over the last 20 years, institutional investors have structurally altered their portfolio's, increasing allocations to real assets such as farmland and water.
- The agricultural sector has historically been less sensitive to periods of economic contraction, both domestically and globally.[1]
- Select Australian farmland and water assets have exhibited attractive investment characteristics over time providing competitive risk-adjusted returns and low correlation relative to traditional asset classes.[2]
- The early indications are that Agriculture, considered an 'essential service producing essential goods' in Australia and most US states, is one of the few industries displaying stable economic outcomes as the impacts of COVID-19 disrupt global asset classes.
- The agriculture sector globally is underpinned by compelling long-term structural tailwinds that increasingly favour Australia.
- Appropriately structured agricultural portfolios have the potential to provide consistency of income, often at a premium to cash rates, provide a hedge against inflation and benefit from operational value add.[3]

INTRODUCTION

Over the 15 years to March 2020, Australian equities have increased 6.4% p.a.[4], US equities have increased 7.8% p.a., the Australian dollar (vs the US Dollar) has peaked at $1.11 and troughed at $0.56[5] and the Reserve Bank of Australia and US Federal Reserve have set very accommodative monetary policy. During the Global Financial Crisis in 2008, Australian equities fell 54% and US equities fell 58%. Over the past month financial markets have gyrated at warp speed. The exact economic impact is uncertain but clearly, with a significant proportion of the global population restricted indoors we should expect economic contraction close to, if not surpassing, historical events of the early 1920s.

Periods of market volatility, heightened synchronization of financial markets globally and an increased focus on asset valuations has prompted a shift in asset allocations. Over the last 20 years, institutional investors, seeking to capitalize on favorable long-term supply and demand fundamentals and develop portfolios less sensitive to periods of economic contraction have structurally altered their portfolio's increasing allocations to real assets, such as farmland. If expectations match actual results (and they rarely do exactly), investors that have diversified portfolio allocations will not have avoided the recent market volatility but rather will have weathered the storm much better than those that did not adjust.

For astute sophisticated investors, this shift presents opportunities as new agricultural investment products, backed by specialist teams, provide exposure to previously difficult to access and assess private market assets that have exhibited attractive return characteristics over time.

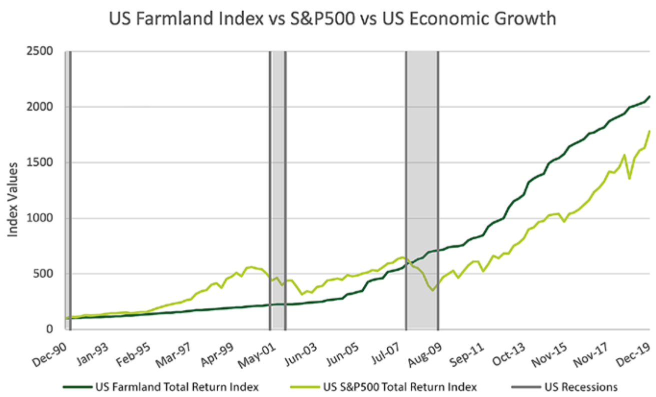
There is much that is uncertain in the post COVID-19 business and economic environment. Over the next three to six months RCP will share key insights and impacts of COVID-19 on the agriculture sector. This paper is part one of a series of discussion papers that looks at Agriculture's emergence as an institutional asset class, its fit within portfolio's and historical resilience to economic shocks.

THE AGRICULTURE SECTOR IS LESS SENSITIVE TO PERIODS OF ECONOMIC CONTRACTION

Demand for agricultural goods is relatively price inelastic. The value of key agricultural assets (farmland and in the Australian context water) are driven by factors not commonly associated with traditional markets. Unsurprisingly, historical returns of select agricultural assets have shown to be uncorrelated with traditional markets and resilient to periods of economic contraction and financial uncertainty.[6]

It is too early to understand the full extent of COVID-19 on economic growth rates globally and particularly growth rates across key agricultural trade partners, especially in the Asian region. That said, as outlined by the IMF, experience from the Global Financial Crisis suggests that a global downturn will affect the volume of trade across products unevenly, with trade in consumer non-durables (being a single use good such as food and drink) affected least and capital and consumer durable products most affected.[7]

Chart 1: US Farmland Returns Resilient to Economic and Market Cycles (1990-2019)



A GLOBALLY RENOWNED AGRICULTURE PRODUCER IN A DYNAMIC NEIGHBOURHOOD

Australia has developed a comparative advantage globally in the production of agricultural goods, has the largest area of certified organic farmland in the world, has the second largest agricultural area, is known for its safe and high quality food and has proximity and access advantages to Asian markets.[8]

Food demand is projected to increase by 60-70% by 2050 driven by population growth and higher per capita incomes. The regional distribution of global populations and the location of the new middle-class population is particularly advantageous for the Australian agricultural sector.

The global population is expected to increase by more than 50 million people, or double Australia's population, each and every year through 2050.[9] Asia is expected to account for 41% of the global population growth through 2050.[10] In 2017 alone the global middle class expanded by approximately 140 million people, more than five times Australia's population.[11] The overwhelming majority of the new middle class, 88 percent, are expected to live in Asia.[12]

ECONOMICALLY ESSENTIAL GOODS WITH ATTRACTIVE INVESTMENT CHARACTERISTICS

The agriculture sector globally benefits from long-term structural tailwinds that increasingly favour Australia. Select Australian farmland and water assets have exhibited attractive investment characteristics over time providing; competitive risk-adjusted returns relative to traditional asset classes; low correlation to traditional asset classes; less sensitivity to periods of economic contraction and an effective hedge against inflation.

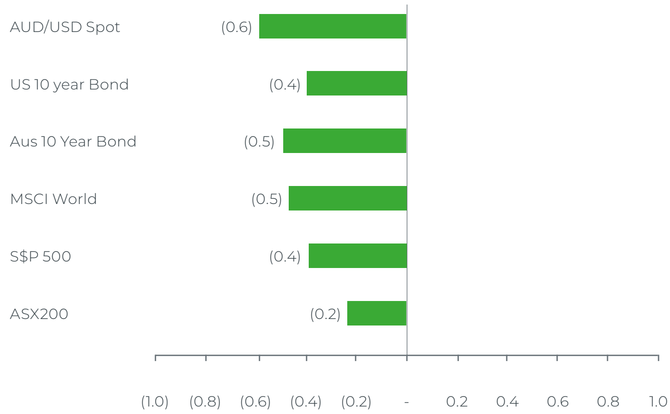
The early indications are that Agriculture, considered an 'essential service producing essential goods', is one of the few industries displaying stable economic outcomes as the impacts of COVID-19 disrupt global asset classes.

Chart 2: Investment Characteristics[13]

	Agriculture	Stocks	Bonds	Real Estate	Cash
Mainstream Asset Class	✗	✓	✓	✓	✓
Attractive Returns	✓	✓	✗	✓	✗
Economic Resilience	✓	✗	✗	✗	✓
Equity-Like Growth	✓	✓	✗	✓	✗
Keeps Pace with Inflation	✓	✓	✗	✓	✗
Liquidity	✗	✓	✓	✗	✓
Hard Asset	✓	✗	✗	✓	✓
Essential Good	✓	✗	✗	✓	✗
Sustainability / ESG Impact	✓	✓	✓	✓	✗

Similar to other real asset investments, agricultural assets, due to historical low correlation to traditional equity and fixed-income markets, have the ability to smooth portfolio returns. Appropriately structured agricultural portfolios, have the potential to provide consistency of income, often at a premium to cash rates, provide a hedge against inflation and benefit from operational value add.[14]

Chart 3: Australian Water Entitlements Correlation with Other Asset Classes (July 2008 – June 2019)[15]



SIGNIFICANT OPPORTUNITIES IN A GROWING AND FRAGMENTED SECTOR

Australia has developed a capacity to feed approximately 75 million people.[16] Global population demographics are expected to drive an increase in demand for agricultural goods at a time when future growth in supply is challenged by the declining availability of natural resources (arable land and water).[17,18] The size and growth of Australia's key agricultural export partners dwarfs Australia's productive capacity. To meet demand, the agricultural sector will require sustained productivity grains and significant capital investment.

Agriculture sector participants with strong balance sheets, long-term horizons, established networks, sector expertise and diversified mandates tend to be well placed to access attractive investment opportunities in a fragmented market and capitalize on favourable long-term fundamentals.

COMPELLING TAILWINDS FOR FOOD AND AGRICULTURE SECTOR INVESTMENT

Investor exposure to real assets has traditionally been a key point of difference amongst institutional investors.[19] The agriculture sector is more investor-friendly than ever and has significantly matured over the past two decades, presenting a compelling option for many investors. Whilst exposure through direct acquisition of farmland or listed equities can be achieved, investing in unlisted agricultural managed funds can provide benefits of:

- Reduced correlation with listed securities as compared to LICs, LITS and REITS;
- Potentially less drawdown during periods of economic downturn;
- Increased diversification and scale benefits; and
- Access to experienced teams of agricultural investment managers.

Australian agriculture is well positioned as a globally competitive producer of high-quality agricultural goods and a major agricultural commodity exporter located within close-proximity to evolving Asian markets.

The next six to twelve months may again prove Agriculture's resilience in times of economic contraction as COVID-19 disrupts global economies.

RIPARIAN CAPITAL PARTNERS

Riparian Capital Partners, a specialist water, agriculture and food investment firm, focuses solely on identifying, acquiring and managing investments across the agricultural sector. Through its investment strategies, Riparian provides investors with exposure to a diverse range of Australian agriculture sector assets. Riparian's investment strategies have been designed to provide investors uncorrelated returns to traditional markets, a mix of yield and capital growth and deliver liquidity options seldom offered on private market real asset investment products.

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"**Riparian zone**" refers to a broad zone spanning from the riverbank to the floodplains; it occasionally includes hill slopes that may influence the stream ecosystem.

Oxford Dictionary 2018

NOTES

1. RCP Analysis, 2020. Past performance is not indicative of future results which may vary.
2. RCP Analysis, 2020. Past performance is not indicative of future results which may vary.
3. Zenith Investment Partners, 2019 & Callan, 2017, Real Assets Reporter.
4. Reserve Bank of Australia.
5. Reserve Bank of Australia.
6. RCP Analysis, 2020. Past performance is not indicative of future results which may vary. Risk and return profile of each asset class varies.
7. International Monetary Fund, 2010, World Economic Outlook.
8. Michigan State University, 2018, Feeding the world in 2050 and beyond.
9. https://www.worldometers.info/world-population/#total
10. Michigan State University, 2018, Feeding the world in 2050 and beyond.
11. Brookings Institute, 2017, The unprecedented expansion of the global middle class
12. Brookings Institute, 2017, The unprecedented expansion of the global middle class.
13. Past performance is not indicative of future performance which may vary. Risk and return profile of each asset class varies.
14. Zenith Investment Partners, 2019.
15. Annual correlation data points. RCP analysis 2020.
16. RCP Analysis 2020 based on percentage (~60%) of Australian agricultural goods that are exported and Australia's population.
17. The World Bank, 'Arable Land', World Bank Open Data, Data retrieved on the 10th June 2019.
18. Water Resources Group, 2009, Changing our Water Future.
19. Zenith Investment Partners, 2019.

DISCLAIMER

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