

Content Includes:

Investor Appetite for Natural Resources

We take a detailed look at how institutional investors access the natural resources asset class.

Investment Preferences

Energy is the most favoured strategy among natural resources investors.

Investor Expectations

Majority of investors believe the performance of natural resources funds has not met expectations.

Key Challenges

Performance and market volatility are seen as the biggest challenges for the industry in 2015.

Long-Term Outlook

Investors' allocations to natural resources are likely to increase over the coming year and longer term.

Preqin Special Report: Institutional Investors in Natural Resources Funds

October 2015





Foreword

The natural resources industry has been attracting significant attention over recent years as investors search for strong risk-adjusted returns that display low correlation to traditional asset classes. The economic downturn following the 2008 crash led to a flight to safety as investors targeted assets which they believed could act as a store of value; however, with the macroeconomic landscape shifting, have investor attitudes towards natural resources also shifted?

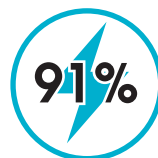
With this in mind, we set out to investigate these investors' perspectives, preferences and plans for the natural resources industry by interviewing 160 investors globally. Preqin Special Report: Institutional Investors in Natural Resources Funds examines the following:

- How institutional investors view natural resources
- Institutional investors' preferences for natural resources
- How investors access the asset class
- Investors' future plans and activity in natural resources

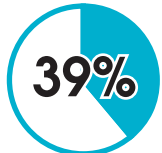
Key Facts



Four out of five institutional investors in natural resources access the market via unlisted funds.



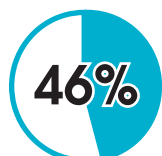
Proportion of respondents that invest in the energy sector.



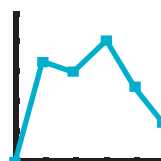
Proportion of respondents that have a fixed target allocation to natural resources.



37% of investors have a positive perception of the natural resources industry, with a further 48% having a neutral perception.



Proportion of investors that allocate to natural resources from their real assets allocation.



Performance of natural resources funds has fallen short of expectations for 63% of respondents.

Natural Resources Online - Coming Soon!

Launching in Q4 2015, **Natural Resources Online** will be Preqin's first online module focusing solely on the natural resources industry. Natural Resources Online will provide detailed information and intelligence on institutional investors, fund managers and fundraising in the industry and much more across the following areas:

- Energy, including Oil & Gas
- Metals & Mining
- Agriculture/Farmland
- Timberland
- Water

Please get in touch to register your interest or to request more information: info@peqin.com

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Investor Appetite for Natural Resources

Natural resources have a long history of attracting capital from institutional investors, and with many struggling for yield in a challenging financial environment over recent years, interest in the asset class has been growing. During the financial crisis, as many structured financial instruments struggled, we saw a strong increase in the price of commodities such as gold, which can act as a store of value. Natural resources are often seen as reasonably uncorrelated to equities markets and can also act as an inflation hedge – issues investors have become increasingly concerned about following major losses for many in their portfolios following the 2008 crash.

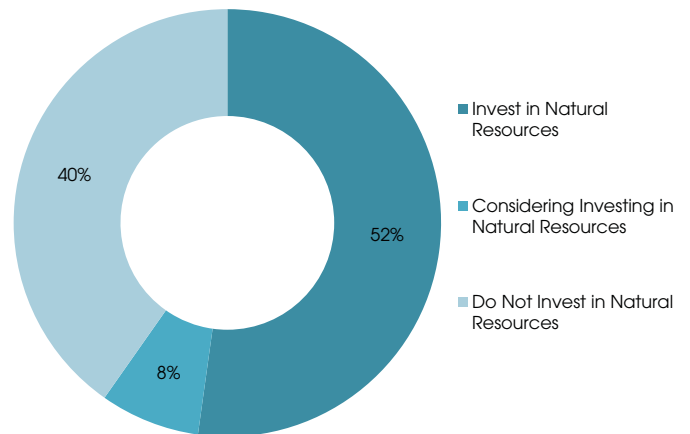
Significant fluctuations in various commodity prices over recent years have led to an unpredictable environment for natural resources investments, which will always be somewhat inherently tied to underlying commodity prices. It is in this context that Preqin recently surveyed a global selection of 160 institutional investors to shed some light on their thoughts on the natural resources industry, how they access the market and their future plans for their natural resources portfolios.

The results of the survey indicate investors continue to view natural resources as an important part of their investment strategy as they look to build diverse portfolios that will maximize returns while minimizing downside risk.

Investors in Review

Of the 160 institutional investors surveyed by Preqin, over half (52%) currently actively invest in the natural resources asset class, with a further 8% considering making their maiden allocation (Fig. 1). This does, however, leave a significant 40% of respondents that do not currently allocate to the asset class, although over the coming years it is likely we will see the number of active investors increase as more look to natural resources to provide diversification to their portfolios.

Fig. 1: Proportion of Institutional Investors Investing in Natural Resources

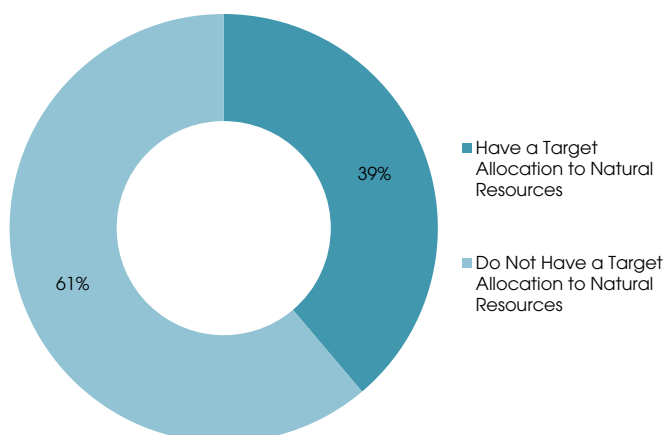


Source: Preqin Investor Survey, June 2015

Interestingly, of those respondents that currently invest in natural resources, 61% do not maintain a specific target allocation to the asset class (Fig. 2); this indicates that a significant proportion of investment in the asset class is opportunistic at present, conducted out of investment buckets for other asset classes. Furthermore, of those investors active in natural resources, the average current allocation is 1.9% of total assets, suggesting there is significant capacity for investors to ramp up their allocations if they see strong opportunities in the space.

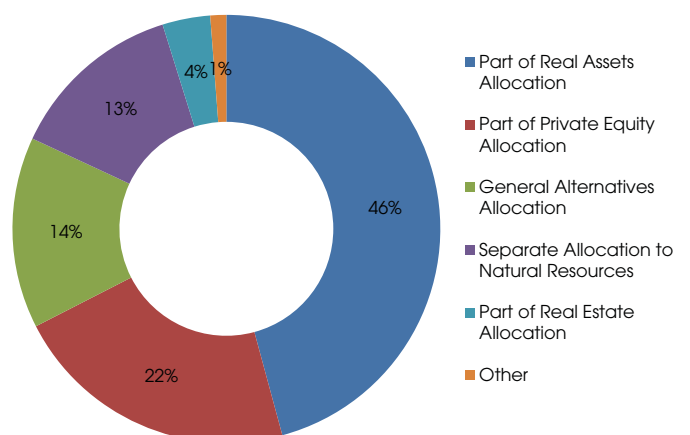
With the majority of investors having relatively small amounts of capital placed in natural resources and investing on an opportunistic basis, it is important to understand in which allocations they typically place their natural resources investments (Fig. 3). Perhaps unsurprisingly, nearly half (46%) of investors make investments in natural resources via their real assets portfolios, which likely also consist of investments such as infrastructure and potentially real estate.

Fig. 2: Proportion of Institutional Investors with a Target Allocation to Natural Resources



Source: Preqin Investor Survey, June 2015

Fig. 3: Breakdown of Institutional Investors in Natural Resources by Source of Allocation



Source: Preqin Investor Survey, June 2015



Twenty-two percent are investing via their private equity portfolio, indicating these investors view unlisted natural resources funds as a form of private equity investment, likely focusing more on the structure of the investment than the underlying asset. Importantly for the growth of natural resources as a standalone asset class, 13% of investors now maintain a separate allocation to the asset class; this may well increase going forward as investors struggle to bundle together real assets such as infrastructure with natural resources due to the inherently different underlying assets and risk/return profiles.

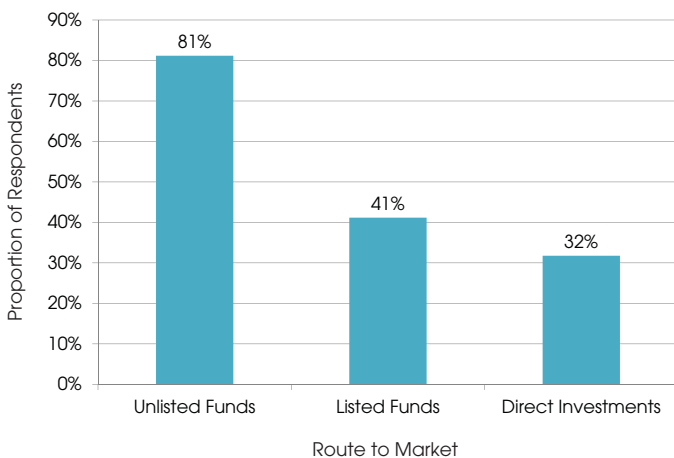
Route to Market

As the natural resources asset class evolves and grows, there is increasing choice for investors looking to put capital to work. Traditionally, a significant number of investors have accessed natural resources via private equity-style unlisted natural resources funds or through listed natural resources funds, which may be utilized by investors less comfortable with the illiquid nature of unlisted funds. Direct investments are also becoming increasingly prevalent among investors, as a way to avoid fees and gain greater control of their portfolio. These types of investments are primarily the preserve of large institutional investors with the significant in-house resources required to execute and manage these types of investments.

As shown in Fig. 4, 81% of active investors surveyed access the asset class via unlisted funds, with a comparatively smaller 41% investing via listed funds. This shows institutional investors are typically happy to lock up capital, perhaps believing that long-term investments in natural resources are more desirable than shorter term listed investments whereby performance may focus more on fluctuating commodity prices rather than managers creating value. Nearly a third (32%) of investors access the asset class via direct investments, indicating that, while most would turn to third parties to manage their natural resources investments, a significant minority are willing and able to execute direct investments.

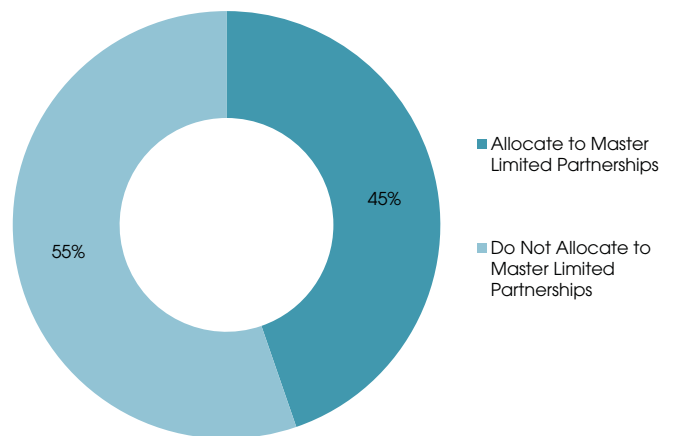
Master Limited Partnerships (MLPs) have attracted a growing amount of attention in recent years as an alternative way for investors to access the natural resources asset class. MLPs have to invest 90% of their assets in 'qualifying income', which is primarily defined as natural resources, real estate and commodities. MLPs display many of the more desirable features of both listed and unlisted natural resources funds, namely the liquidity of listed funds and various tax benefits of unlisted limited partnership funds. As shown in Fig. 5, 45% of the investors we spoke with are open to investing in MLPs, indicating strong investor demand for this method of accessing the asset class.

Fig. 4: Breakdown of Institutional Investors in Natural Resources by Route to Market



Source: Preqin Investor Survey, June 2015

Fig. 5: Proportion of Investors' that Allocate to Master Limited Partnerships



Source: Preqin Investor Survey, June 2015

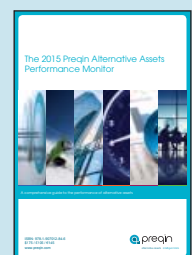
The 2015 Preqin Alternative Assets Performance Monitor

The 2015 Preqin Alternative Assets Performance Monitor provides unrivalled insight into the performance of alternative assets funds, analyzing performance data for over 20,500 funds.

Bringing together extensive data from Preqin's industry-leading online products, the Performance Monitor offers detailed statistics, league tables, charts and analysis of performance across the alternative assets industry.

For the first time, the 2015 edition has been expanded to cover analysis of all alternative assets funds, including natural resources, private equity & venture capital, private debt, real estate, infrastructure and hedge funds.

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Strategies and Geographies Targeted

With natural resources attracting significant attention in recent years, increasing focus is being placed on the specific types of natural resources, rather than simply viewing it as a singular asset class. Different types of natural resources can be classified by various factors, both geopolitical and economic, and as such, it follows that the investment horizons and risk profiles are not singular. For example, in the US, the shale boom has likely had significant implications for investments in energy; however, it will have less of an impact on agriculture investments, which in turn may be affected by drought in California. As a result of these different drivers, it follows that many investors will have distinct preferences for particular types of natural resources.

A significant 91% of active investors in natural resources that were surveyed invest in energy (Fig. 6), which is perhaps unsurprising considering the relative size and maturity of the industry compared to many other types of natural resources.

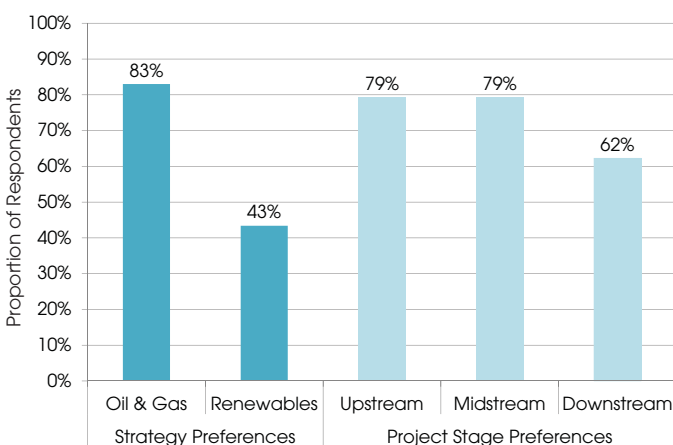
Over half of all active investors consider metals & mining (59%) and timber (51%) investments, with a notable 47% actively investing in farmland/agriculture. Interestingly nearly a third (31%) of investors now consider investments in water, which, until recently, was a fairly niche strategy that is now becoming more prevalent as water security and shortages become increasingly mainstream issues.

Energy Preferences

With energy being the most prevalent natural resources strategy among investors, it is useful to dig a little further into investors' preferences within the strategy. As shown in Fig. 7, 83% of investors active in energy target oil & gas investments and 43% invest in renewables, which is to be expected given the relative size of the two industries.

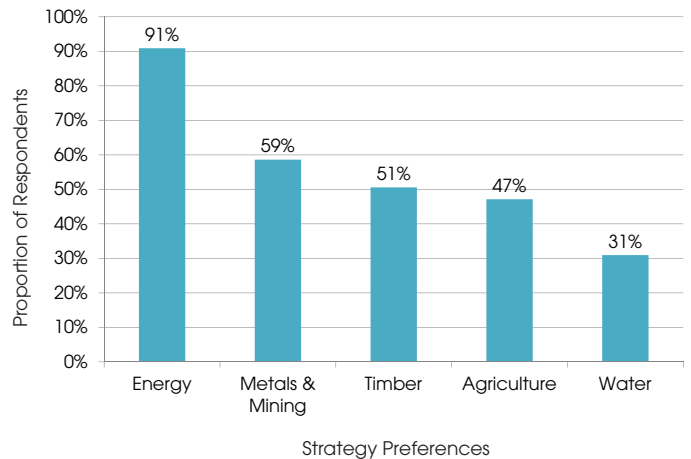
Alongside the underlying asset, investors also have options regarding the project stage of their underlying investments which will have different risk/return profiles. Seventy-nine percent of

Fig. 7: Institutional Investors' Energy Preferences



Source: Preqin Investor Survey, June 2015

Fig. 6: Institutional Investors' Natural Resources Strategy Preferences



Source: Preqin Investor Survey, June 2015

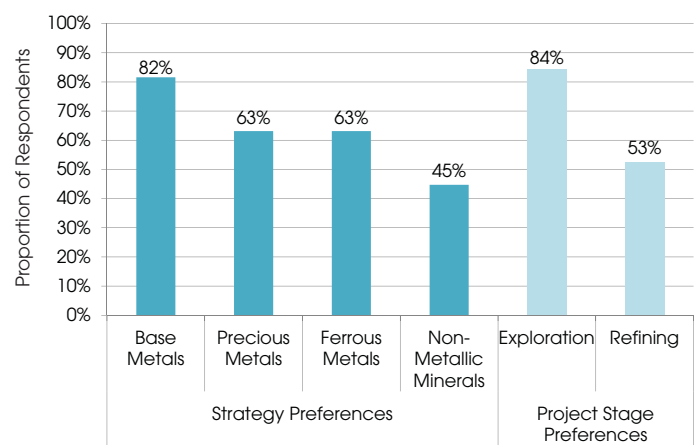
investors are open to both upstream and midstream opportunities, with 62% investing in downstream; this seems to illustrate that investors are typically open to any stage of investment and implies that they are willing to delegate expertise and decisions to fund managers, alongside looking to diversify their portfolio at the project stage.

Metals & Mining Preferences

Similar to energy, various metals have different investment horizons and risk profiles, with certain metal commodities prices fluctuating more widely and some typically tracking wider global markets more closely than others. Among active investors, base metals are invested in by 82% of investors, followed by precious and ferrous metals, each cited by 63% of investors.

In terms of the stage of investment, the vast majority (84%) of investors are open to exploration, compared with 53% that invest

Fig. 8: Institutional Investors' Metals & Mining Preferences



Source: Preqin Investor Survey, June 2015



in refining. Exploration likely has higher risk/return potential and more scope for manager outperformance than refining, which will likely be more closely correlated to commodity prices.

Natural Resources – A Global Industry

As is often the case with alternative investments, there is a geographic preference among investors for North America, which is perhaps seen as more developed and potentially less vulnerable to geopolitical factors than other regions (Fig. 9). However, in contrast to many alternative investments, there is also a strong preference for investments in natural resources on a global scale. As natural resources funds focus on assets that, in the majority of cases, cannot be created in the same way that real estate and infrastructure can, it is expected that for investments such as oil & gas or metals upstream/exploration, the investment somewhat needs to focus on the arbitrary geographic location of the asset, perhaps explaining the preference for global investments.

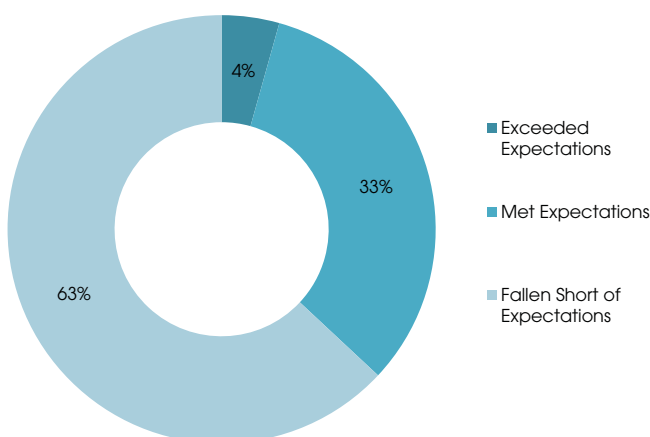
Investor Perceptions of the Natural Resources Industry

As shown in Fig. 10, investors are generally positive or neutral about the natural resources industry at present, with only 15% expressing a negative view of the industry. This is despite the performance of natural resources investments falling short of expectations for 63% of respondents in the past year (Fig. 11), which could well be explained by low commodity prices such as for oil over the previous 12 months.

Therefore, unsurprisingly, performance was stated by the largest proportion (54%) of respondents as a key issue affecting the natural resources industry in 2015 (Fig. 12). Ongoing volatility and uncertainty in global markets was named by 40% of respondents, perhaps explained by demand for the underlying natural resources assets in some cases being very much tied to global economic trends. Other key issues named by over a quarter of investors were valuations (33%), regulation (31%) and the exit environment (25%).

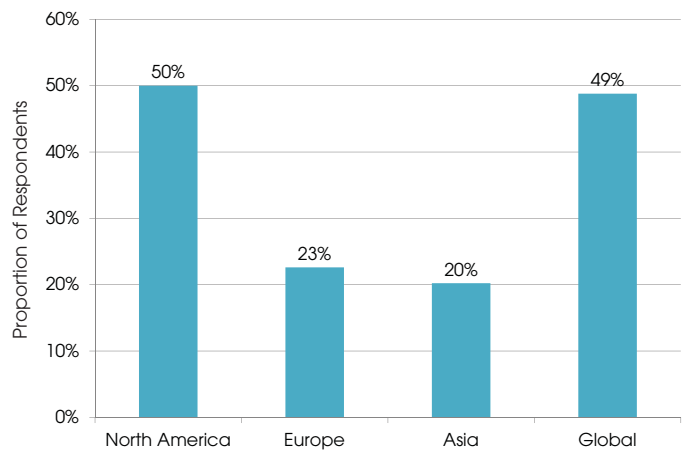
Despite these recent performance struggles, the fact that investors generally maintain a neutral or positive view of the industry as a whole indicates that investors believe natural resources investments can bounce back and provide strong risk-adjusted returns in the coming years.

Fig. 11: Proportion of Institutional Investors that Feel Their Natural Resources Fund Investments Have Lived up to Expectations over the Past 12 Months



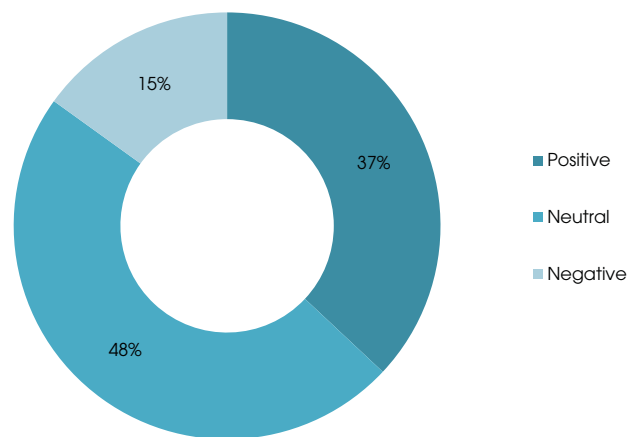
Source: Preqin Investor Survey, June 2015

Fig. 9: Institutional Investors' Natural Resources Geographic Preferences



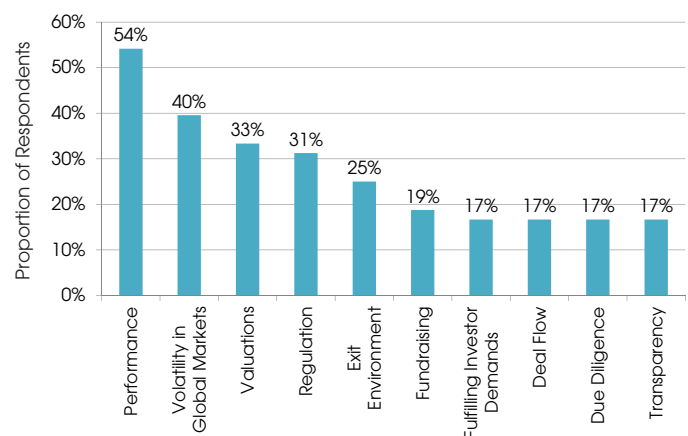
Source: Preqin Investor Survey, June 2015

Fig. 10: Institutional Investors' General Perceptions of the Natural Resources Industry



Source: Preqin Investor Survey, June 2015

Fig. 12: Institutional Investors' Views on the Key Issues Affecting the Natural Resources Industry in 2015



Source: Preqin Investor Survey, June 2015



Investor Activity over the Next 12 Months and the Longer Term

The outlook for natural resources fund managers in the coming year looks reasonably positive, with over a quarter (27%) of investors surveyed expecting to commit more capital in the coming 12 months compared with the previous year (Fig. 13). Furthermore, half of investors surveyed stated that they would commit the same amount of capital to the asset class in the next 12 months as they did in the past year, with a slightly smaller proportion (23%) looking to scale back the amount of capital they will be allocating to the asset class.

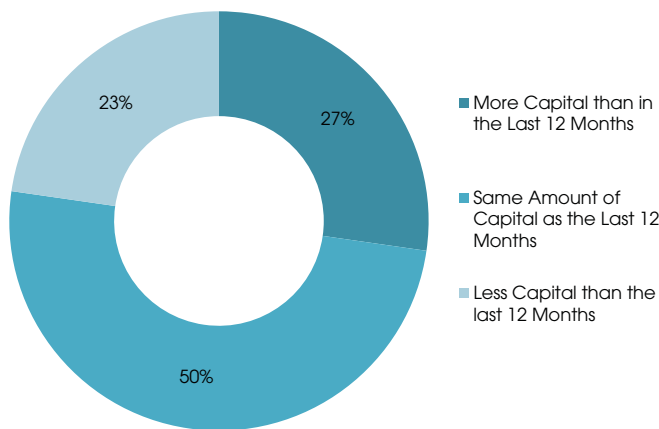
With investors largely looking to allocate the same or more capital to natural resources investments in the next 12 months, it is interesting to look at how investors feel their allocations to natural resources will evolve over the longer term. As shown in Fig. 14, 29% of investors in natural resources are looking to increase their allocation to the asset class in the longer term,

with a significant 59% planning to maintain their current level of exposure to natural resources. Importantly, only 12% expect to decrease their exposure.

Outlook

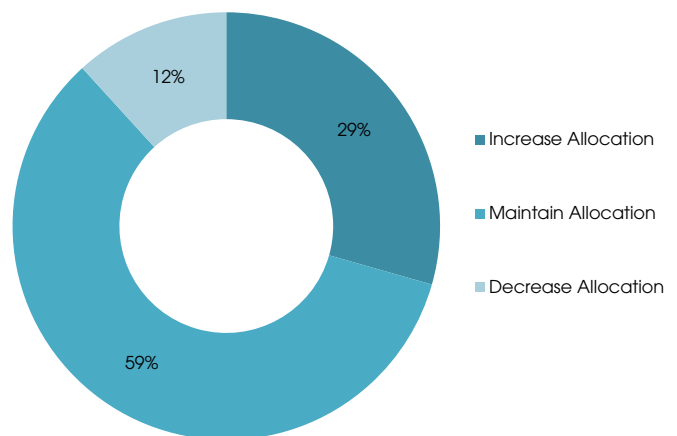
Despite concerns over recent natural resources performance, the outlook for the asset class is positive. Investors have significant options in the industry, including which bucket they allocate to the asset class from, the types of natural resources they can invest in and the routes via which they can access the asset class. Investors can be seen to be positive towards the asset class, with many looking to ramp up their level of exposure to the asset class over the longer term, indicating increased capital is likely to be put to work over both the coming year and in the longer term.

Fig. 13: Institutional Investors' Expected Capital Commitments to Natural Resources Funds in the Next 12 Months Compared to the Last 12 Months



Source: Preqin Investor Survey, June 2015

Fig. 14: Institutional Investors' Intentions for Their Natural Resources Allocations over the Longer Term



Source: Preqin Investor Survey, June 2015

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Fax: +1 440 445 9595

London:

3rd Floor
Vintners' Place
68 Upper Thames Street
London
EC4V 3BJ

Tel: +44 (0)20 3207 0200

Fax: +44 (0)87 0330 5892

Singapore:

One Finlayson Green
#11-02
Singapore 049246

Tel: +65 6305 2200

Fax: +65 6491 5365

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