



accordant

# Building a More Balanced Portfolio

**Risk-Optimized Investment Solutions**

Using Private Real Estate

FEBRUARY 2024

# Executive Summary<sup>1</sup>

- Based on a changing definition of risk combined with diminished expectations around the future economic environment, the 60% stock and 40% bond (60/40) portfolio may no longer be the most efficient asset allocation mix
- While the 60/40 has worked in the past, it is likely to fall short of meeting client needs going forward and the mix of only two asset classes may call into question truly how diversified this portfolio is for investors
- Portfolios can achieve better risk-return optimization through the inclusion of Private Real Estate (PRE), a multi-dimensional asset class with the potential for attractive returns, enhanced income, diversification, and inflation protection benefits
- Building a more balanced portfolio of stocks, bonds, and private real estate can help to achieve a more efficient frontier and can lead to more successful financial outcomes for investors

This report will cover the following critical topics:

1

INTRODUCTION

2

60 / 40 ≠ MOST EFFICIENT PORTFOLIO

3

**CRE:** A MULTI-DIMENSIONAL ASSET CLASS SOLUTION

4

MORE BALANCED PORTFOLIOS = MORE SUCCESSFUL OUTCOMES

5

CONCLUDING THOUGHTS

1. The information contained herein is not intended to constitute legal, tax, securities, or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. The information, analysis, and opinions expressed herein are for general information only and are not intended to provide specific advice or recommendations for any individual or entity.

# I. Introduction

What we are proposing here is not an entirely novel concept. In fact, the Talmud (c. 1200 BC to 500 AD) said:

“Let every man divide his money into three parts, and invest a third in land, a third in business, and a third let him keep in reserve.”<sup>2</sup>

Apparently, these early theologians knew something about risk and return and may have even been the world’s first advocates of asset allocation and diversification, thousands of years before Harry Markowitz and his idea of Modern Portfolio Theory was even born. **A more contemporary translation of the preceding advice might read: each investor should create a balanced portfolio that is equally allocated across asset classes such as real estate, common stocks, and fixed income.**

While this sounds like extremely prudent financial advice on its face, let’s examine it in more detail. The aggregate portfolio is invested one-third in bonds and the remaining two-thirds in equity investments through real estate and stocks. The one-third allocated to fixed income mitigates higher volatility risk inherent in the other two-thirds allocated to the aforementioned equity investments. **Diversification across the two major forms of equity investing – real estate and stocks – with different sources and patterns of return further reduces the equity risk, assuming no hedging has taken place. The outcome is a balanced portfolio, where private CRE serves as the third-leg of the stool in a portfolio, behind stock and bond allocations, and therefore can be appropriate for an investor with a longer investment time horizon, who is simultaneously concerned about risk and return.** It is a remarkably elegant and powerful asset allocation strategy, and in our opinion its ancient logic still holds today.



2. Seeking Alpha. The Timeless Talmud Strategy and Its Role in Asset Allocation. Published September 14, 2011. <https://seekingalpha.com/article/293665-the-timeless-talmud-strategy-and-its-role-in-asset-allocation>

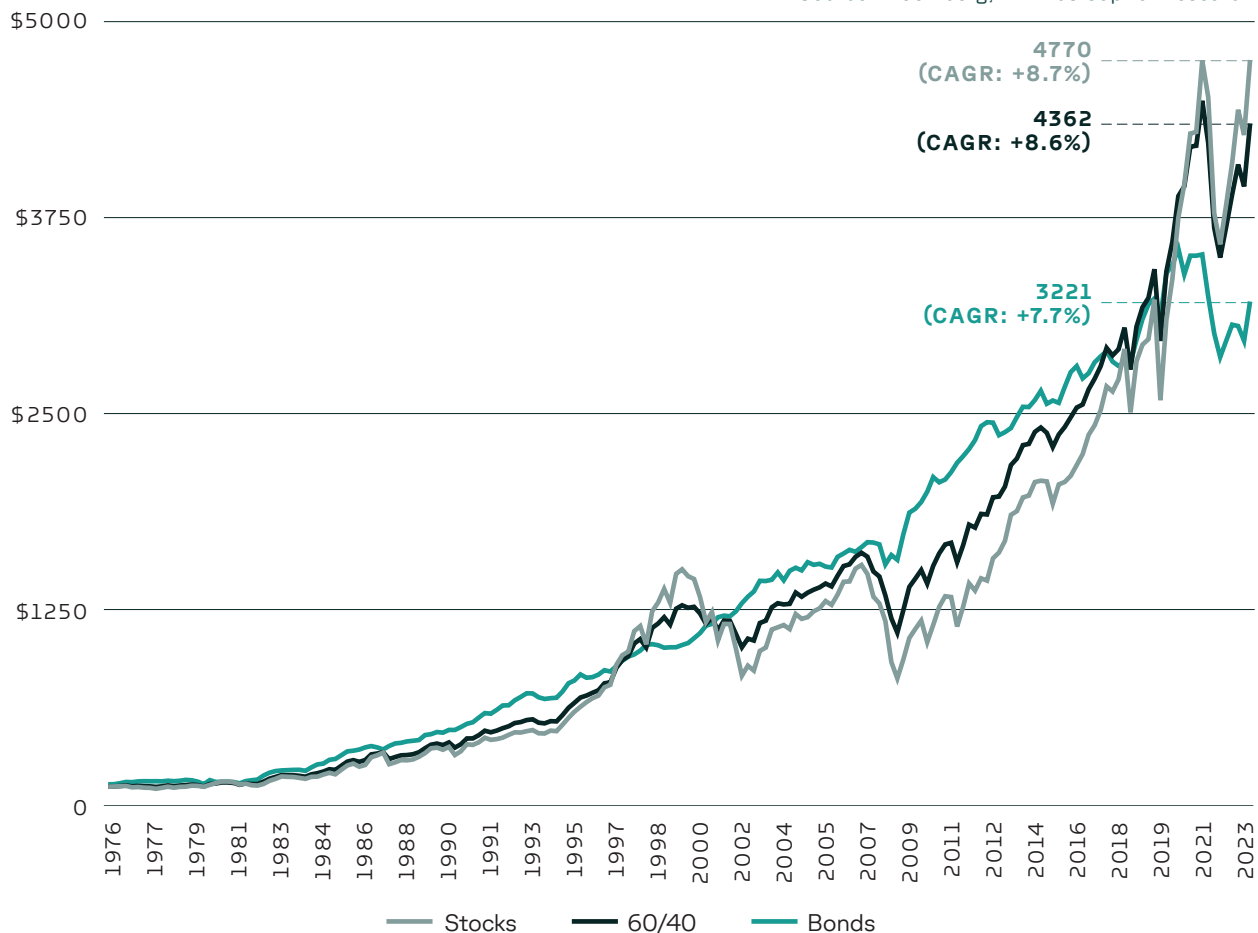
## II. 60/40 May No Longer be the Most Efficient Portfolio

The 60/40 portfolio – comprised of 60% common stocks or equities and 40% bonds or fixed income securities – traces its roots back to the 1950s or around the same time as Nobel laureate Harry Markowitz’s pivotal theory of portfolio selection.<sup>3</sup> Central to his work on Modern Portfolio Theory was the fact that investing requires facing risk. **As such, an “efficient” portfolio is one that maximizes the potential returns at each level of risk (or minimizes risk for each level of potential return).**

Essential to this is asset allocation. It is intended to help design efficient or risk-optimized portfolios for each investor from the available investment universe. Given that asset allocation optimization is an assumption-heavy exercise that also requires a fair amount of computing power, simple rules of thumb such as “100 minus your age” were developed. For an average investor with a moderate risk tolerance, many have considered a blend of 60% equities and 40% fixed income to be an appropriate starting point. For over 40 years, the classic 60/40 portfolio (**Exhibit 1**) has worked well for many investors and consequently has been the recipient of billions, if not trillions, of dollars in investor wealth over that time span.

**EXHIBIT 1: GROWTH OF \$100 SINCE 1976**  
TRAILING PERFORMANCE FOR EQUITIES, BONDS, AND BLENDED 60/40 PORTFOLIO WITH ANNUAL REBALANCING

Source: Bloomberg, Affinius Capital Research

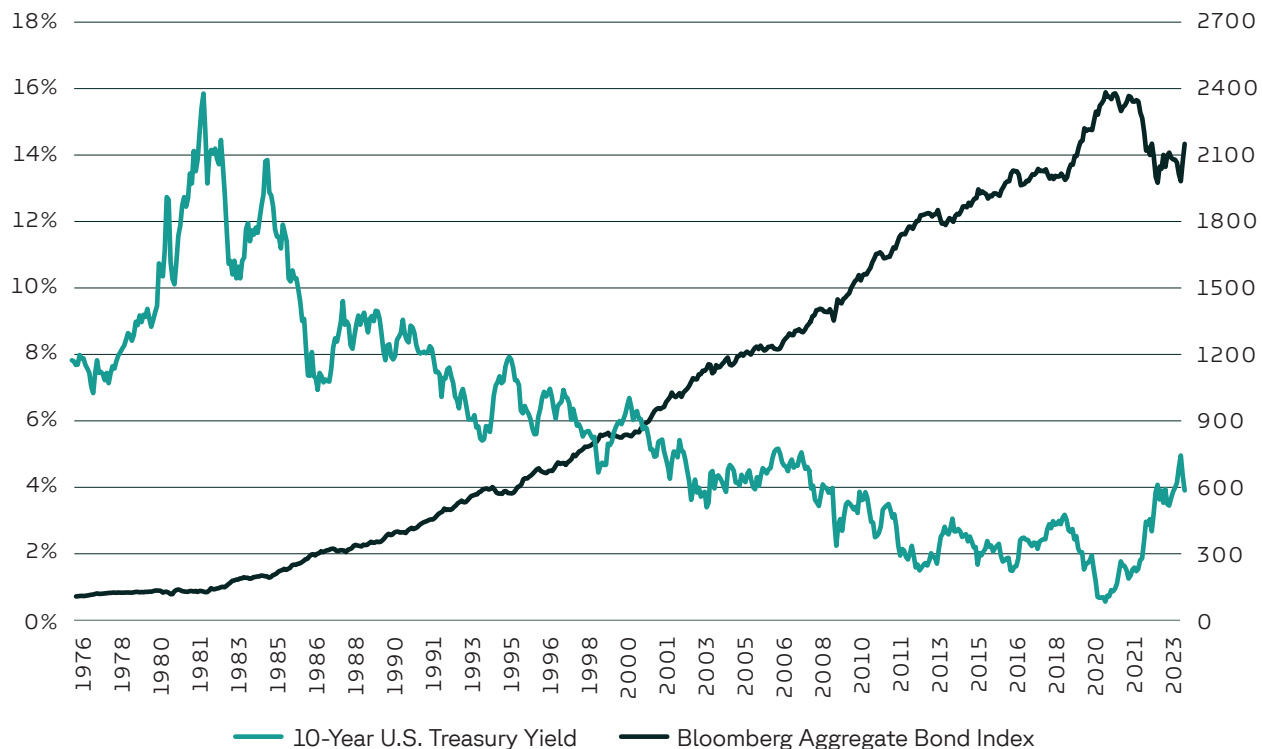


3. The Nobel Prize. Prize in Economic Sciences 1990 – Press Release. Published October 16, 1990. <https://www.nobelprize.org/prizes/economic-sciences/1990/press-release/>

Frankly, fixed income performance has benefitted immensely from the secular decline in interest rates since the early 1980s (Exhibit 2). With this prior tailwind having become a recent headwind for investors, the inclusion of private CRE could increase potential returns while reducing overall risk, resulting in a more efficient multi-asset class portfolio.

**EXHIBIT 2: SECULAR DECLINE IN INTEREST RATES TAILWIND TO FIXED INCOME PERFORMANCE — 1976 TO 2023**

Source: Bloomberg, Affinius Capital Research

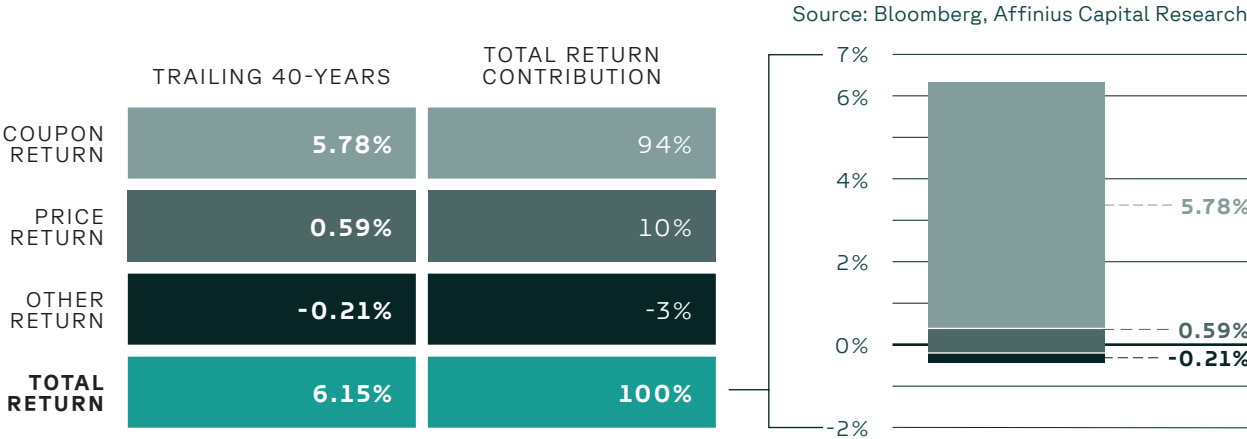


# Interest Rates and Fixed Income Returns

Today, the Bloomberg U.S. Aggregate Bond Index (formerly the Barclays Capital Aggregate Bond Index), also known as “the Agg”, is a primary fixed income benchmark that has an option-adjusted duration of 6.2 years. **This means a 1% increase in interest rates results in a roughly 6.2% decline in bond value.** Fundamentally, increasing interest rates negatively impact the total returns of fixed income securities if sold before maturity because interest rates and bond prices are inversely related – **as interest rates rise, all things being equal, bond prices fall.** This concept in fixed income investing is known as interest rate risk and is usually measured by duration. Duration is only meant to describe the relationship between the price of a bond and prevailing interest rates and does not give any indication regarding an issuer's ability to make interest and principal payments. It's important because fixed income returns are comprised of a coupon payment plus, or minus, the change in value of the underlying bond due to the shift in interest rates (**Exhibit 3**).

**Decomposing the sources of total return for the Agg (Exhibit 3), over the last 40 years the coupon return has averaged 5.78%** (shown in light gray) **in addition to 0.59% from capital appreciation** (shown in dark gray). This means that of the 6.15% total return achieved by bonds since 1982, 94% of the return has been generated from coupon payments and nearly 20% has come from the price appreciation component. During that same time period, the yield on the 10-Year U.S. Treasury Note declined from a high of 15.8% in September 1981 to a low of 0.5% in July 2020.

**EXHIBIT 3: DECOMPOSITION OF HISTORICAL TOTAL RETURNS FOR FIXED INCOME**  
 TRAILING 40-YEAR FIGURES: MEAN TOTAL RETURN AND COMPONENT PARTS FOR THE BLOOMBERG AGGREGATE BOND INDEX



Today, with interest rates hovering in the 4.0% range, further capital appreciation seems improbable in many respects. Thus, **the best an investor can achieve in fixed income is the current nominal coupon return of roughly 4.0% – a far cry from the 40-year average coupon rate north of 6%.** Using our duration calculus from before and **given the Agg's duration of 6.2, then a 3% increase in interest rates would lead to a roughly 18.6% decline in bond prices.**

In summary, given the current trajectory of interest rates, we predict that the future return of fixed income is likely to be much lower than over the past 40 years, which dramatically increases the opportunity cost of portfolio ownership relative to other potentially higher returning asset classes that also offer other compelling investments benefits. **What has historically served as a secular tailwind for fixed income has in many respects now become a headwind to overall portfolio performance for investors still wed to the 60/40 portfolio.**

## How is Risk Defined in a Portfolio?

In financial theory, the classical definition of risk is represented by the total volatility of an asset or portfolio and measured by the standard deviation of observed or expected returns. Still, total volatility remains a nebulous concept for most investors. From a practical perspective, many investors define risk as either shortfall risk (i.e., not having enough money to achieve their financial needs) or risk of capital loss on a permanent basis. Kahneman and Tversky have demonstrated the behavioral trait of loss aversion in that investors feel more pain, or displeasure, from losses than pleasure felt from gains. **Using this more practical definition of risk, fixed income has shifted from an asset class that mitigates risk, by reducing overall portfolio volatility, to one that creates risk by increasing the potential for shortfall or permanent loss of capital.**

## The Episodic Nature of Equity Returns

One thing that hasn't changed is the episodic nature of equity returns. While many investors attempt to predict the future direction of the equity markets, looking at fundamental or technical indicators, studies have indicated that attempting to time the market is a futile pursuit for even the most experienced investors. The 40-year total return of equities has been 11.3% on an annualized basis, yet these returns have been delivered to investors very erratically. **Heightened equity volatility combined with cognitive dissonance due to innate behavioral tendencies makes it extremely challenging for many investors to stay invested.**

Notably, investors must remain invested, maintaining exposure at all times in order to achieve the consistent and full stream of returns. **This is sometimes easier said than done as periods of heightened market volatility causes investors to panic and behave irrationally at exactly the wrong time.** As such, investors can sometimes be their own worst enemies. For example, a recent study by Dalbar suggests that this suboptimal investment decision making, or the "behavior gap" as they term it, results in an annual return drag of roughly 3.5% over the last 30 years ending in 2021.<sup>4</sup>

4. Dalbar. Dalbar Quantitative Analysis of Investor Behavior (QAIB) 2022 Study. Released April 2022.





The decade of the early 2000s has been called the “lost decade” and highlights how equity returns may not always be dependable for investors. For instance, over this roughly 10-year timeframe, even with full re-investment of dividend income, U.S. large company stocks generated a compound annual return of just 0.4% (Exhibit 4) in nominal terms. **A strategy of investing in bonds, stocks, and real estate would have mitigated the downside risk in two ways.**

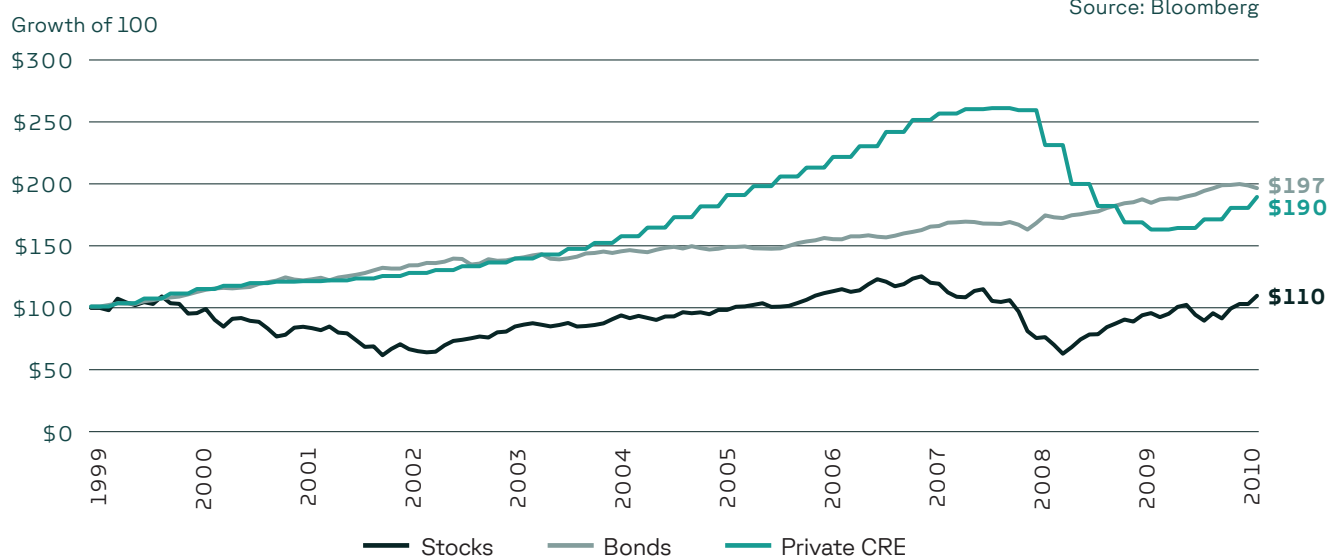
The first was bond diversification. During the 2000s, U.S. bonds earned a compound annual return of 6.3%. Even though, in the long run, bonds have lower hypothetical returns than stocks, they can provide a cushion against a period of poor U.S. stock performance. For example, over period of the “lost decade”, an annually rebalanced portfolio that allocated one-third to U.S. bonds and two-thirds to U.S. stocks earned a compound annual return of 2.1%. Although, this return was not sufficient to keep pace with the decade’s 2.5% inflation rate, the return was at least positive on a nominal basis. A portfolio built with bonds, stocks, and real estate offered a second way to mitigate risk: diversification across two forms of equity investing with different patterns of returns. Even though U.S. stocks cumulatively lost money in real terms, private real estate had a compound annual return of 6% during the “lost decade”.

Diversification across equity asset classes with different underlying return drivers mitigated downside risk without resorting to diversification into asset classes with lower hypothetical returns.

Given an allocation of one-third U.S. bonds, one-third U.S. stocks, and one-third private CRE, the strategy is still equity-oriented. It nevertheless generated a compound annual return of 4.3%, handily beating inflation. **The strategy’s return was particularly impressive given that U.S. stocks had their second worst 10-year holding period since 1926.** Of course, there is no assurance that this strategy will as easily handle the next “lost decade”; however, with the uncertainties facing investors, multi-asset class investing in stocks, bonds, and private real estate could be a prudent investment approach.

**EXHIBIT 4: A LOST DECADE OF EQUITY RETURNS**  
TRADITIONAL ASSET CLASS PERFORMANCE – 2000 TO 2010

Source: Bloomberg



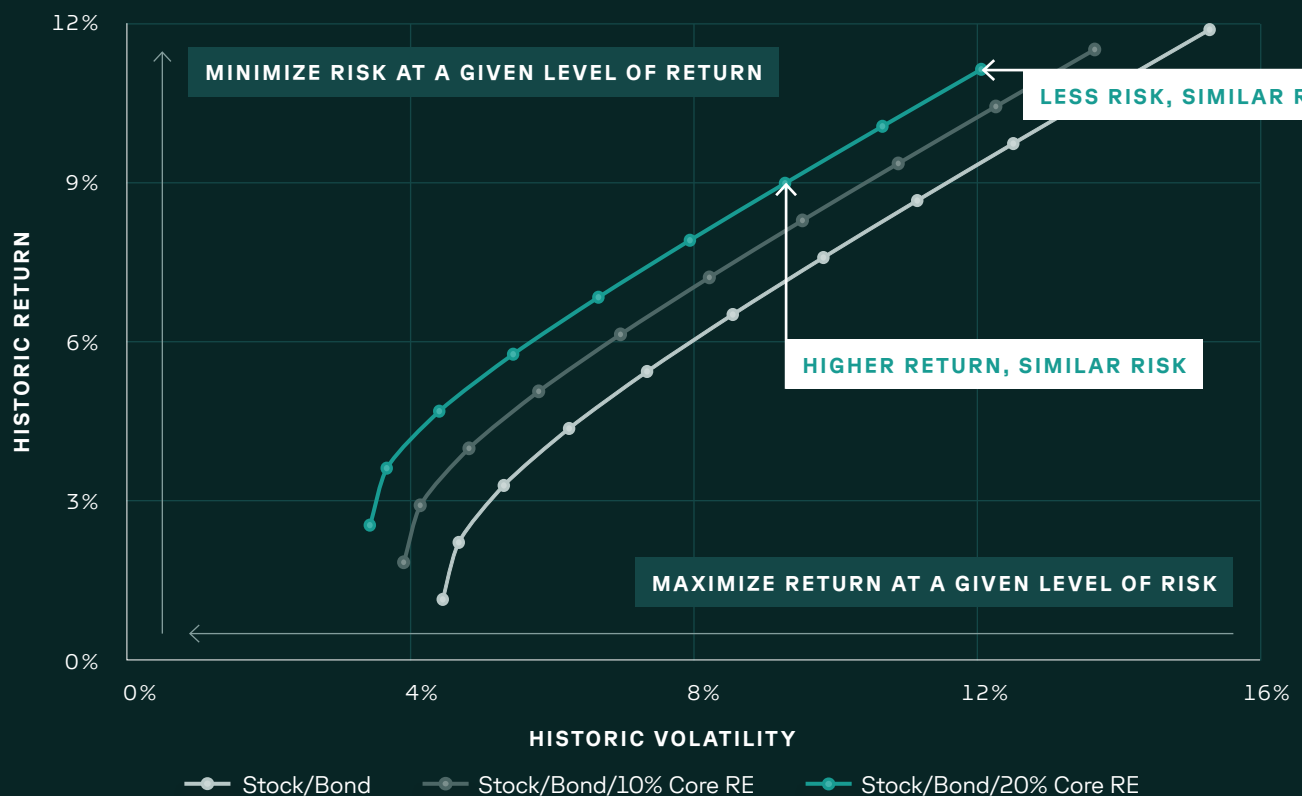
### III. Private CRE — A Multi-Dimensional Asset Class — Provides the Solution

To resolve the previously mentioned challenges, the solution lies in seeking asset classes with a higher return than fixed income that can also provide stable returns, as measured by lower volatility than equities. This is critical because the economic environment is setting up in contrast to one that would yield another multi-decade bull market for bonds due to a secular decline in interest rates. Assets with a low correlation to other traditional equity and fixed income investments can further reduce total portfolio volatility. **In an optimization framework, these can serve to improve the position and shape of the efficient frontier due to the added diversification, effectively pushing the frontier up and to the left that results in better and smoother returns for investors.** Foundationally, substitution of one investment for another by modifying asset allocation can improve the characteristics of the portfolio in a fairly intuitive way, as shown by the top line below that consists of 20% to private real estate via a reduction in fixed income exposure (**Exhibit 5**).

#### EXHIBIT 5: THE MORE EFFICIENT FRONTIER

TRAILING 10-YEAR PERIOD THROUGH FOURTH QUARTER 2023: RETURN AND VOLATILITY FOR VARIOUS CRE ALLOCATIONS

Source: Bloomberg, Affinius Capital Research [For illustrative purposes only and does not represent any forecast of risk and return. Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. It is not representative of a projection of any specific investment.]



**Private real estate is a versatile asset class that warrants inclusion in a balanced, diversified portfolio.** From a historical risk and return perspective, real estate sits between equities and fixed income, allowing it to substitute for either. As described earlier, it has a low relative correlation to both equities and fixed income, which can provide a meaningful improvement in the efficiency or risk-optimization of the portfolio. Real estate also offers a higher current yield than equities or core fixed income, which is a valuable tool for advisors whose clients need income to meet regular, ongoing expenses. Lastly, it can provide some degree of protection from inflation.

From a financial perspective and particularly in relation to Modern Portfolio Theory, **an improvement of the efficient frontier** (moving either up or to the left, or more optimally a move up and to the left simultaneously) **is a meaningful outcome for advisors and investors because the impact it can have on the risk-adjusted nature of long-term total returns on a compound basis.** This positive impact comes in addition to the fundamental benefits of diversification and capital preservation that private CRE has historically offered to strategic investors in the asset class. Using the building blocks approach to estimating hypothetical asset class returns (**Exhibit 6**) can help uncover why private real estate provides such added diversification relative to stocks and bonds in the context of a wholistic investment portfolio. In part due to different underlying drivers and dynamics of its total returns, a few of which are discussed below.

**EXHIBIT 6: THE BUILDING BLOCKS APPROACH TO ASSET CLASS RETURNS**

Source: Barclays Private Bank, Affinius Capital Research [For illustrative purposes only.]

ASSET CLASS	BUILDING BLOCKS OF TOTAL RETURNS				
	INCOME		GROWTH		VALUATION
FIXED INCOME	Treasury Yield	Credit Spread	Roll Return		Treasury Yield Curve Adjustment Credit Spread Adjustment
EQUITIES	Dividend Yield	Net Buyback Yield	Real Earnings Growth	Inflation	Multiple Expansion / Contraction
HEDGE FUNDS	Quantitative Approach				
PRIVATE EQUITY	Public Market Benchmark			Illiquidity Premium	
PRIVATE CRE	NOI Yield	NOI Growth	Replacement Cost Adjustment	Cap Rate	

Net operating income (NOI) is a key profitability metric used to analyze income-producing real estate investments. NOI measures the rental income or revenue of a property less the associated operating expenses (management fees, property taxes, landlord insurance, maintenance and repairs, utilities, etc.). To note, NOI doesn't account for income taxes and also excludes debt repayment and interest charges, capital expenditures, or depreciation and amortization expenses.

Similarly, weighted average lease term (WALT) can be used as a comparative metric for duration, or cash flow tenor, for commercial real estate. As of third quarter 2023, the NCREIF ODCE Index (which investors pronounce as "odyssey" and for more explanation please reference **Exhibit 7**) had an average WALT of 4.8 years when looking at the cash flow characteristics of its leases, which would put it in the neighborhood of intermediate-term fixed income securities. Importantly, **where nominal bond yields can't adjust for inflation, commercial real estate features leases that are inflation-indexed and can experience price appreciation through value-add creation or cap rate adjustment (Exhibit 6).**

The capitalization rate (cap rate) is the rate of return, expressed in percentages, that a real estate investment property is expected to generate. The cap rate is derived by dividing the NOI of a property by the property's current market value and helps estimate the potential return on the investment and is also useful to assess the relative value of comparative properties. This metric is in some ways similar to bond yields, in that high-quality properties will feature the lowest market yields or cap rates, whereas Class B and Class C quality assets will have higher cap rates, generally due to the lower valuation of the income streams imbedded in the calculation.

Looking to the future, there is a high likelihood that the secular tailwinds that have helped propel certain asset classes (e.g. favorable treasury yield curve adjustment for fixed income, multiple expansion for equities) may be reversing and are now becoming headwinds in effect. **On the other hand, private CRE offers many diversified sources of total returns and different levels of risk, allowing investors to tilt towards income (e.g., core, core-plus) or growth (e.g., value-add, opportunistic) strategies.**

## The Role of Inflation

A primary driver of the 40-year secular decline in interest rates has been the declining and persistently low inflation since the Great Inflation of the late 1970s to early 1980s. Inflation has once again surged to the top of investor's consciousness, with headline inflation recently hitting a 40-year high. To note, inflation can damage investors in several ways:

- Inflation makes everyday goods more expensive, thereby decreasing the purchasing power of savings. **Thus, investors may need to demand more from their portfolios in terms of yield and total return in order to maintain their current standard of living.** This phenomenon is exacerbated by increasing life expectancies, putting even more pressure on a portfolio to generate enough spendable income to last over an even longer period of time in retirement.
- In the U.S., the Federal Reserve typically attempts to control inflation by raising interest rates. Higher interest rates directly reduce the value of bonds, due to the duration concept described earlier. They generally also negatively impact the value of equities, as investors demand a higher rate of return for holding risky assets. This double whammy effect can have severe financial consequences for the classic 60/40 portfolio of stocks and bonds.
- **Therefore, inflation can negatively impact the total returns of both stocks and bonds, calling into question the true level of diversification that just a two-asset class portfolio offers to investors.** Conversely, private CRE can be an effective inflation hedge and our recent report provides a detailed explanation of the topic.



## IV. More Balanced Portfolios Can Lead to More Successful Outcomes

With these clear benefits, it is time to evaluate (or re-evaluate) whether you should be using private CRE in your client's portfolios. Further, recent rule changes have led to increasing accessibility to a wider audience of potential investors that are likely well-suited for private real estate exposure.

### So Where to Start?

Within private CRE, the NCREIF Open End Diversified Core Equity (NFI-ODCE or ODCE) Index is the most widely utilized investment benchmark (**Exhibit 7**) and offers investors the strategic benefits to which the asset class was underwritten – attractive returns, enhanced yield, diversification, and inflation protection. To note, investors cannot invest directly in an index.

#### EXHIBIT 7: A TURN-KEY PRIVATE CRE INDEX NFI-ODCE INDEX DESCRIPTION & REQUIREMENTS

Source: NCREIF

#### NCREIF FUND INDEX - OPEN END DIVERSIFIED CORE EQUITY (NFI-ODCE) INDEX

The NFI-ODCE is a capitalization-weighted, gross of fee, time-weighted return index calculated using a methodology created by the National Council of Real Estate Investment Fiduciaries. NCREIF began calculating the NFI-ODCE in 2006 with data back to 1977. Supplemental data is also provided, such as equal-weight and net of fee returns, for informational purposes and additional analysis. Open-end Funds are generally defined as infinite-life vehicles consisting of multiple investors who have the ability to enter or exit the fund on a periodic basis, subject to contribution and/or redemption requests, thereby providing a degree of potential investment liquidity. The term Diversified Core Equity style typically reflects lower risk investment strategies utilizing low leverage and generally represented by equity ownership positions in stable U.S. operating properties. There are currently 25 private funds that are included in the index.

#### REQUIREMENTS

**Real Estate** – at least 80% of market value of gross assets is invested in “direct real estate” (no more than 20% of such assets invested in cash and/or cash equivalents).

**Domain** – at least 95% of market value of real estate gross assets in U.S. markets.

**Property Types** – at least 75% of market value of real estate gross assets invested in office, industrial, apartment, and retail property types.

**Life Cycle** – at least 75% of gross market value must be invested in properties that are 75% or more leased.

**Leverage** – no more than 35% leverage.

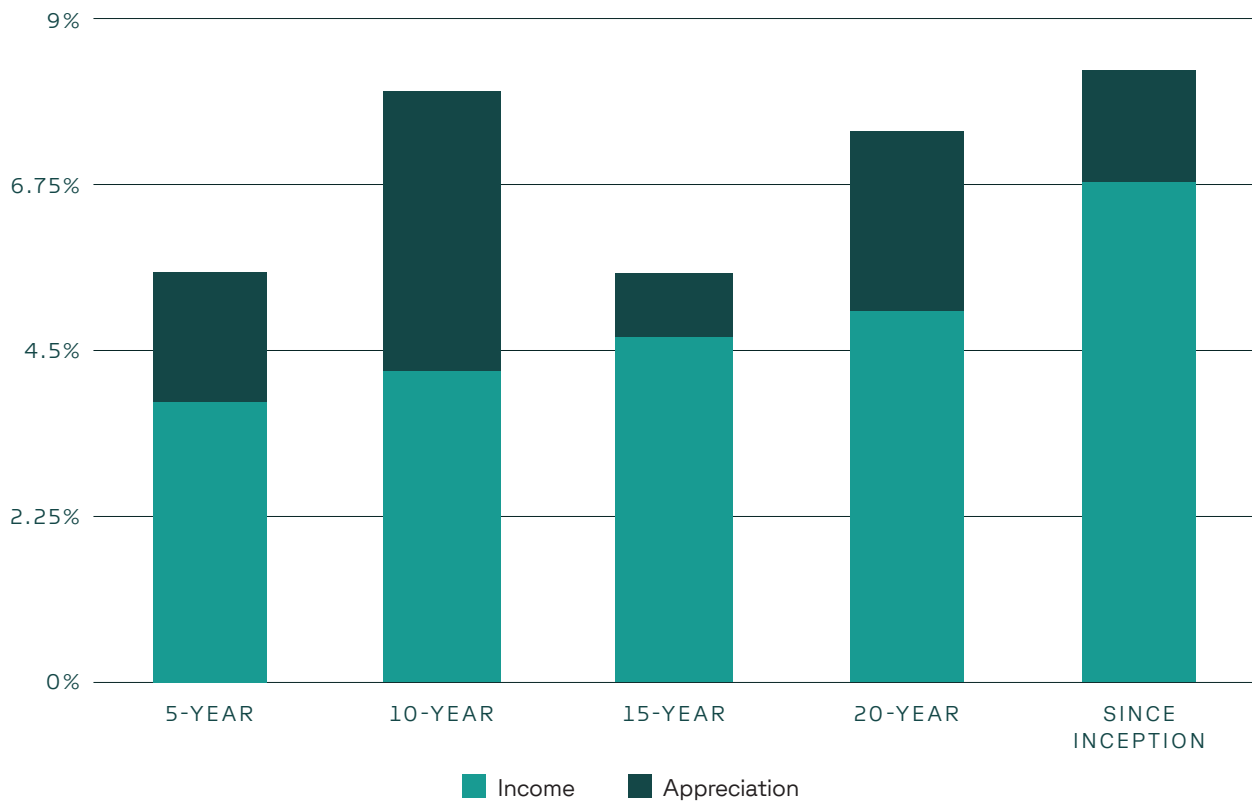
Leverage is defined as the ratio of total debt, grossed-up for ownership share of off-balance sheet debt, to the fund's total assets, also which are grossed-up for such off-balance sheet debt.

**Diversification** – no more than 60% (± for market forces) of gross market value of real estate net assets in one property type or one region as defined by the NCREIF Property Index. The fund must also invest in at least three of the office, industrial, apartment or retail property types, and one of those three types representing a minimum of 5% of direct real estate gross market value.

As well, the diversified and inherently balanced nature of the ODCE means it can provide a strategic index for investors requiring either an income-oriented or growth-oriented strategy to complement their existing investment objectives and level of risk-aversion. **Historically, the ODCE has benefitted from a durable stream of total return that is relatively balanced between income and appreciation, leading to a stable return profile for investors and an excellent source of diversification.** Over the trailing 20-year period, 67% of the total return was attributed to income and 33% to appreciation (**Exhibit 8**), a more resilient profile than other traditional asset classes.

**EXHIBIT 8: ODCE COMPONENT PARTS**  
**NFI-ODCE TOTAL RETURN ATTRIBUTION ANALYSIS – INCOME VS. APPRECIATION**

Source: Bloomberg LP, Affinius Capital Research



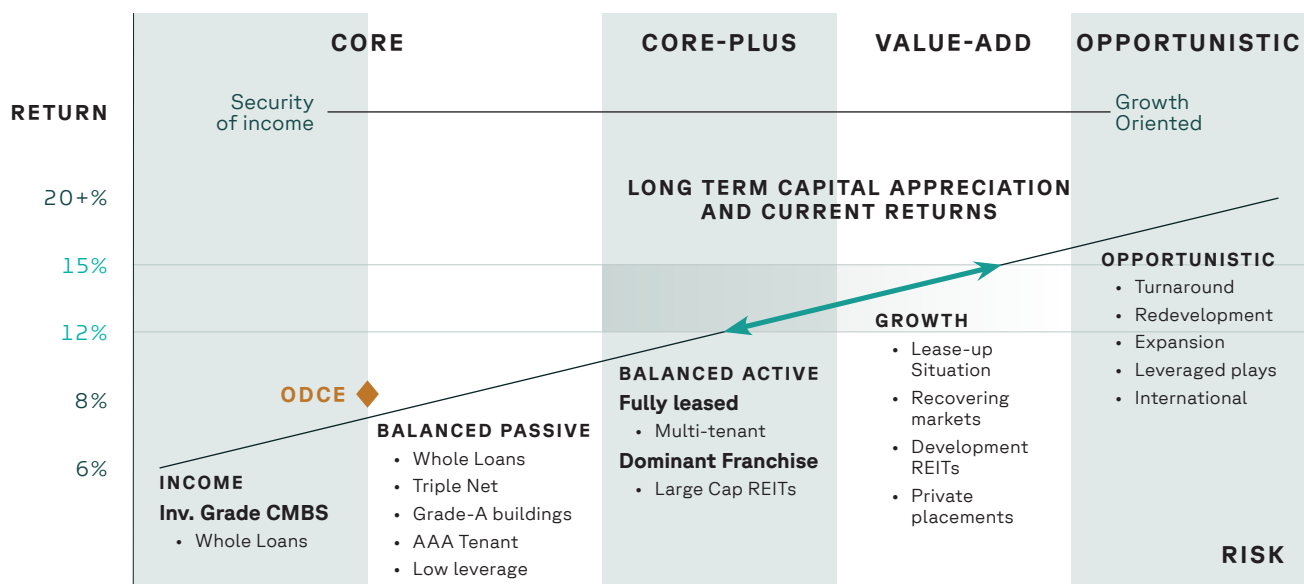
When incorporating private real estate into investment portfolios, what are your actual options (**Exhibit 9**) outside of the ODCE Index (denoted by the diamond below) and what are other important asset class features to consider?

- **Private real estate is not monolithic, rather it is a broad asset class, encompassing many different strategies.** Consequently, these strategies offer different risk and return trade-offs and these differences can be incorporated into either portfolio optimization or substitution frameworks.
- Income-oriented strategies usually consist of net lease (NNN) equity and real estate debt, which generate the majority of their return from current yield. These can be used as fixed income substitutes.
- Core equity strategies, including core and core-plus, focus on high-quality assets in top MSAs with dependable income streams, relatively stable value, and lower leverage. They are often considered “balanced” exposure to real estate, which generate approximately half of their returns through current yield and half through capital appreciation over a full CRE cycle.
- Non-core strategies, including value-add and opportunistic, focus on value creation with the goal of achieving higher returns than typically available in core strategies. The greater volatility of these strategies makes them more like equity strategies in a traditional investment context.

**EXHIBIT 9: A SERIES OF SOLUTIONS ACROSS INCOME AND RETURN**

RISK-RETURN SPECTRUM OF CRE

Source: Affinius Capital Research



RISKS	Minimal	Minimal-Moderate	Minimal-Moderate	Moderate-High
TARGETED RETURNS	6-9%	9-12%	12-18%	18%+
RETURN COMPOSITION	Current Income + Inflation Appreciation	Current Income + Capital Appreciation	Current Income + Capital Appreciation	Capital Appreciation
HOLDING PERIOD	10+ years	5-7 years	5-7 years	5 years or less
LEVERAGE	0-35%	35-60%	60-70%	70%+
INVESTMENT PROFILE	High-quality buildings in top 30 MSAs, prime locations, properties with long-term leases and strong credit tenants	Stabilized buildings generating steady current income	Buildings with upside potential realized through value added asset management	Underutilized assets in need of repositioning

“CRE serves as the **THIRD-LEG OF THE STOOL** in a portfolio, behind stock and bond allocations.”

**GREG STARK**, Chief Executive Officer, Accordant Investments

Considering the challenges fixed income investments recently faced, investors need to evaluate its utility in portfolios relative to the other options available to them. Reducing fixed income to a level that is used to meet near-term spending obligations, particularly in a rising interest rate environment, and residually increasing private real estate portfolio exposure based on its multitude of benefits can be an extremely prudent strategy for investors (Exhibit 10).

**EXHIBIT 10: PORTFOLIO EFFECT BY ADDING CRE?**  
KEY PORTFOLIO STATISTICS — 10-YEAR TRAILING PERIOD AS OF 12/31/2023

Source: Affinius Capital Research (Stocks: S&P 500 Index / Bonds: Bloomberg Aggregate Bond Index / CRE: NFI-ODCE Index)

	60-40 STOCK-BOND PORTFOLIO	60-30-10 STOCK-BOND-CRE PORTFOLIO	60-20-20 STOCK-BOND-CRE PORTFOLIO	PORTFOLIO EFFECT WITH MORE CRE?
TOTAL RETURN	11.09%	11.85%	12.6%	↑
VOLATILITY	8.30%	8.27%	8.26%	↓
YIELD	2.15%	2.38%	2.61%	↑
SHARPE RATIO	1.27	1.36	1.45	↑

The inclusion of private CRE in a portfolio comprised of only stocks and bonds has been shown to materially increase total returns, while simultaneously reducing overall portfolio risk, thereby **leading to a more efficient portfolio (Exhibit 10) with a roughly 30% increase in the Sharpe ratio.**<sup>5</sup> Further, the more efficient portfolio is tilted away from fixed income yet doesn't suffer from a drop in current income, but rather results in a portfolio uplift in yield of over 17% compared to the 60-40 stock and bond portfolio.



5. Sharpe Ratio is the measure of the risk-adjusted return of a financial portfolio. A higher Sharpe ratio portfolio is considered superior to its peers.

# Concluding Thoughts

Given that balancing risk and return will remain a key focus of investors, the addition of private CRE to a classic stock and bond portfolio represents one of the few free lunches existing in the financial arena today. **Further, it is an advancement in the area of Modern Portfolio Theory, effectively modernizing a more balanced portfolio with little to no relative drawbacks for investors versus what is available in the public markets.** Given a diminished prospect of achieving successful investment outcomes using an outdated portfolio approach, this renewed thinking around Markowitz's 1952 seminal research should once again fundamentally transform the way that individuals and even institutions look at sophisticated, risk-optimized investing 70 years later. We hope Dr. Markowitz would be proud.



## Glossary of Key Financial Terms

**Capitalization (cap) rate:** A metric commonly used by real estate managers and investors: the annual net operating income divided by the market value of the property. Describes the relationship between a property's net operating income (NOI) and its market value.

**Cap rate adjustment:** The annual rent actually earned (net of any vacancies) divided by the price originally paid for the property adjusted for any additional capital spending, investments or dispositions made since acquisition.

**Net buyback yield:** The amount of a company's net buybacks divided by its market capitalization.

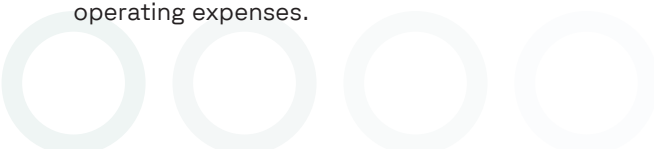
**NOI growth:** Net operating income (NOI) is one of several key metrics used to measure the profitability and value of commercial real estate. NOI is a figure that appears on income and cash flow statements that excludes costs associated with financing and taxes, such as loan payments, capital expenditures, and depreciation. To calculate NOI, a property's operating expenses are subtracted from its total revenue. NOI growth is typically achieved when a property's revenue grows faster or at a rate higher than its operating expenses.

**Cash-on-cash return:** It is a measure of the actual free cash flow generated by the investment divided by the amount of cash invested. It's focus is the return produced by income, not capital appreciation.

**Replacement cost:** The cost to construct a brand new building of similar quality and competitive characteristics in the same location as the existing building at current market prices.

**Volatility:** The standard deviation of the continuously compounded returns on the underlying asset.

**WALT (weighted average lease term):** The time remaining, typically expressed in months or years, between the most recent quarter end and lease expiration for active leases. The Development WALT is a variation of WALT that incorporates leases that have been signed but not yet commenced. These lease maturities are taken as the difference of lease expiration minus lease commencement.



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