



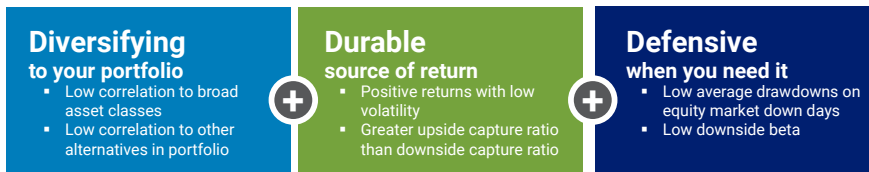
VERIPATH
INVESTOR LETTER
Q3 2023

**Farmland – Diversifying,
Durable & Defensive –
in a Stagflationary World**

INTRODUCTION:

Veripath continues to generate compelling risk-adjusted returns and a recent \$60M acquisition of irrigated land in Alberta brings total assets under management (AUM) to over \$350M (trailing 12 month (TTM) growth of approximately 50%). Also, macro conditions remain favorable to our non-operated, low-leverage approach to farmland investing. (Refer to the Q3 2023 fund factsheet for a detailed review of our portfolio key performance indicators (KPI).)

We have been advocates of material real asset additions to traditional 60/40 portfolios since we launched the first RRSP eligible farmland fund in Canada almost 15 years ago. In this letter, we wanted to take the opportunity to re-iterate our commitment to this approach in light of unfolding economic events and the fact that farmland possesses three qualities that define a useful alternative investment: diversification, durability, and defensibility.



Source: Blackrock

It is well established that farmland tends to outperform in stagflation. We believe this is explained by the inelastic demand curve for food and that farmland is a non-depleting, real asset discounting the production of an infinite series of crops. Could Canada experience stagflation? Stagnant GDP per capita, increasing net capital outflows, declining productivity, low real growth rates, and growing structural fiscal deficits force us to consider this question.

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Chart 1: GDP/Capita – (Current USD\$) – STAGNANT

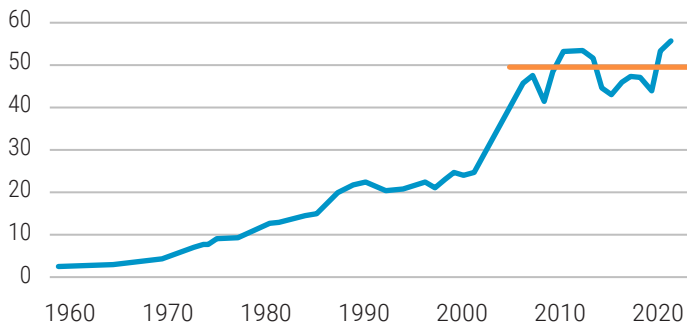


Chart 2: Net Foreign Direct Investment – DECLINING

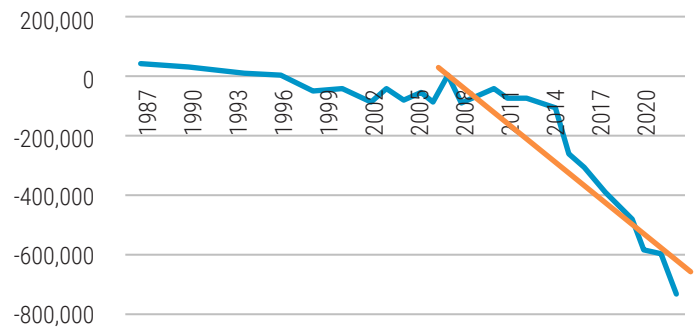


Chart 3: Labour Productivity (Trailing 5-year change %) – DECLINING

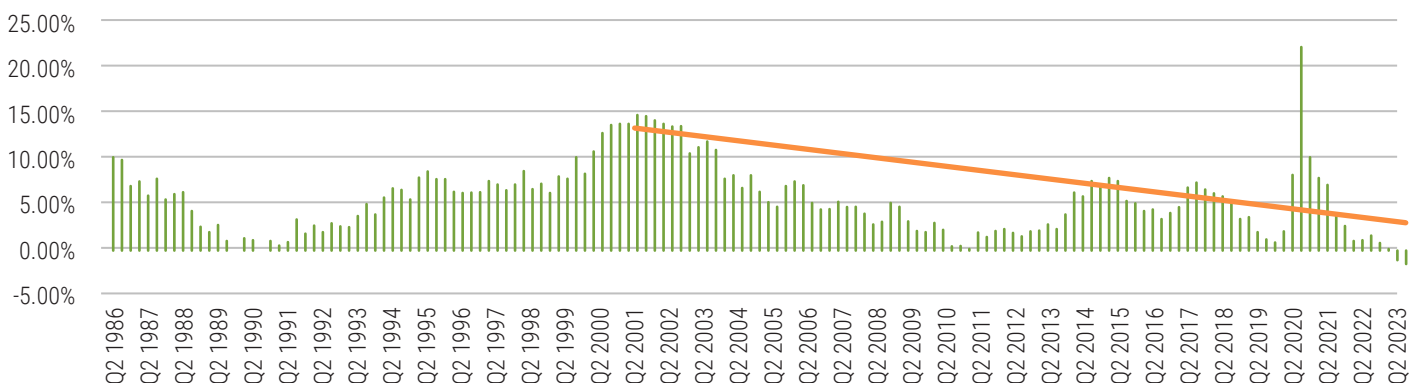
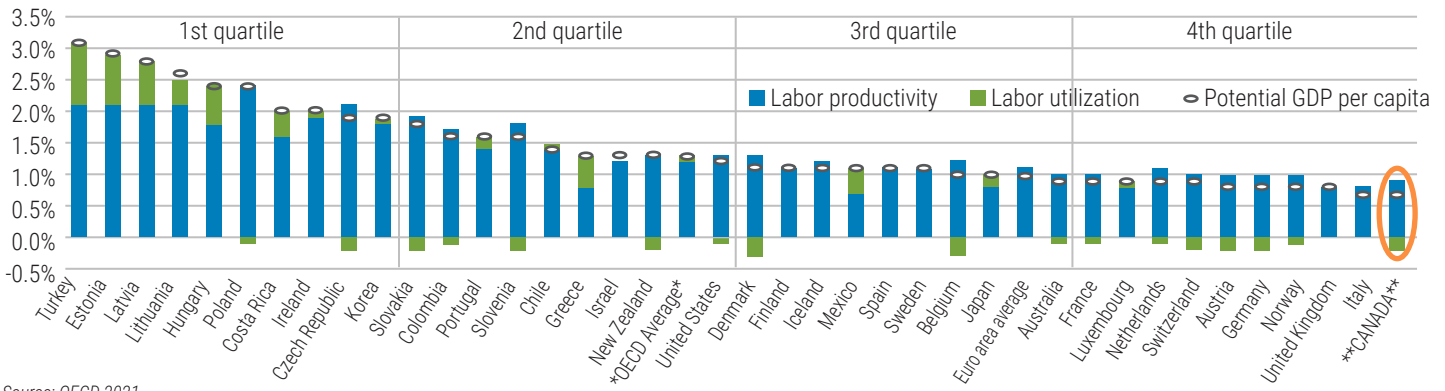
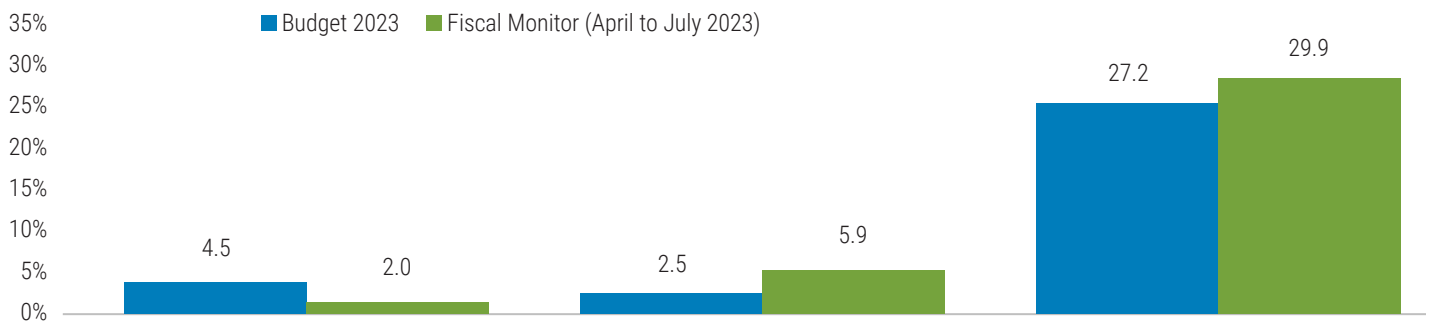


Chart 4: OECD 10-year Real GDP Growth CAGR: 2020-2030 – DECLINING



Source: OECD 2021

Chart 5: Structural Fiscal Deficits (Federal Expenses versus Revenues 2023-2024) – INCREASING



Source: Desjardins Economic Studies

Unless the trends above are addressed, stagflation must be considered a possibility in Canada and then the question becomes whether there are investments that will generate returns in such a climate? While stagflation is a challenging environment in which to invest, the answer is “yes”. We believe that in Canada these investments will tend to be 1) real asset investments displaying asymmetric payoffs to inflation and 2) investments with growth that is linked less to absolute domestic GDP and more to growth from aging demographics or from downward adjustments in the size and purchasing power of the middle class or driven by exporting to markets with more robust macro conditions.

VERIPATH TEAM’S CONTINUOUS QUARTERLY RETURN SERIES:

The Veripath investment team have produced a quarterly return data since inception in 2007 aggregating all transactions undertaken by the all the farmland funds we managed as if they were undertaken by a single fund. The result is 59 quarters of positive returns (2008) – zero drawdowns (rents + land appreciation – unlevered, gross of fees):

- Highest quarter = 5.8%
- Lowest quarter = 2.6%
- Average Quarter = 4.0%

This series encompasses acquisitions/dispositions/holdings across 6 close-ended funds (beginning in 2008) and the 2 open-ended funds currently accepting capital (beginning in 2020) (the “Farmland Funds”). The return data is provided without any impact from leverage in the Farmland Funds – land appreciation and rents – (i.e., it does not account for fund level fees and expenses (including management/performance fees). The closed-ended Farmland Funds did not produce quarterly independent NAVs while the open-ended funds do. However, the data with respect to the closed-ended data is “cash to cash” (i.e., the return is calculated using actual acquisition and disposition values averaged over the period the applicable assets were held, except for one closed-ended fund which continues to hold approximately \$100 million in assets and determines NAV using third party appraisals on an annual basis).*

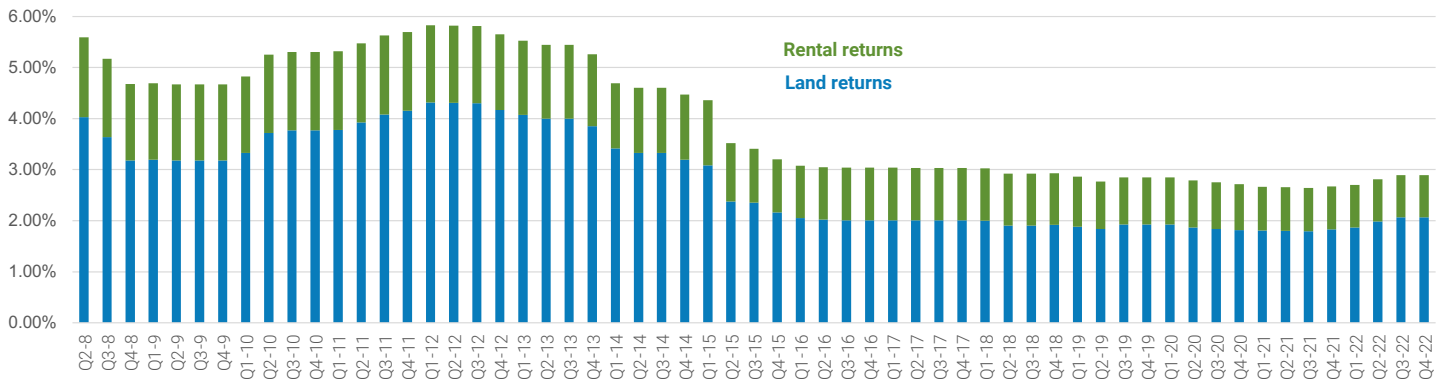
Table 1: Quarterly Return Series

Avg	Hi	Low												
4.99%	5.59%	4.67%	Q2-8	Q3-8	Q4-8	Q1-9	Q2-9	Q3-9	Q4-9	Q1-10	Q2-10	Q3-10	Q4-10	
			5.59%	5.17%	4.68%	4.69%	4.67%	4.67%	4.67%	4.83%	5.26%	5.30%	5.31%	
5.60%	5.83%	5.26%	Q1-11	Q2-11	Q3-11	Q4-11	Q1-12	Q2-12	Q3-12	Q4-12	Q1-13	Q2-13	Q3-13	Q4-13
			5.32%	5.47%	5.63%	5.69%	5.83%	5.82%	5.81%	5.65%	5.53%	5.44%	5.44%	5.26%
3.67%	4.61%	3.04%	Q1-14	Q2-14	Q3-14	Q4-14	Q1-15	Q2-15	Q3-15	Q4-15	Q1-16	Q2-16	Q3-16	Q4-16
			4.69%	4.61%	4.61%	4.47%	4.36%	3.52%	3.41%	3.20%	3.08%	3.05%	3.04%	3.04%
2.93%	3.03%	2.77%	Q1-17	Q2-17	Q3-17	Q4-17	Q1-18	Q2-18	Q3-18	Q4-18	Q1-19	Q2-19	Q3-19	Q4-19
			3.04%	3.03%	3.03%	3.03%	3.03%	2.92%	2.92%	2.93%	2.87%	2.77%	2.85%	2.85%
2.74%	2.89%	2.64%	Q1-20	Q2-20	Q3-20	Q4-20	Q1-21	Q2-21	Q3-21	Q4-21	Q1-22	Q2-22	Q3-22	Q4-22
			2.85%	2.79%	2.76%	2.71%	2.67%	2.66%	2.64%	2.67%	2.70%	2.81%	2.89%	2.89%

Source: Veripath analytics

The primary return element has been land appreciation with rents generating +/- ~25% of the return stream. For investors accustomed to private equity (PE) or infrastructure return profiles this is probably novel. But when you consider farmland's fundamental features, the reasons become evident: farmland is a **non-depreciating asset** that discounts the production of an infinite series of crops. In addition, agricultural commodities have highly inelastic demand, low stock to flow and are fully consumed (i.e. no recycling).

Chart 6: Quarterly Returns – Rents and Land Appreciation Disaggregated



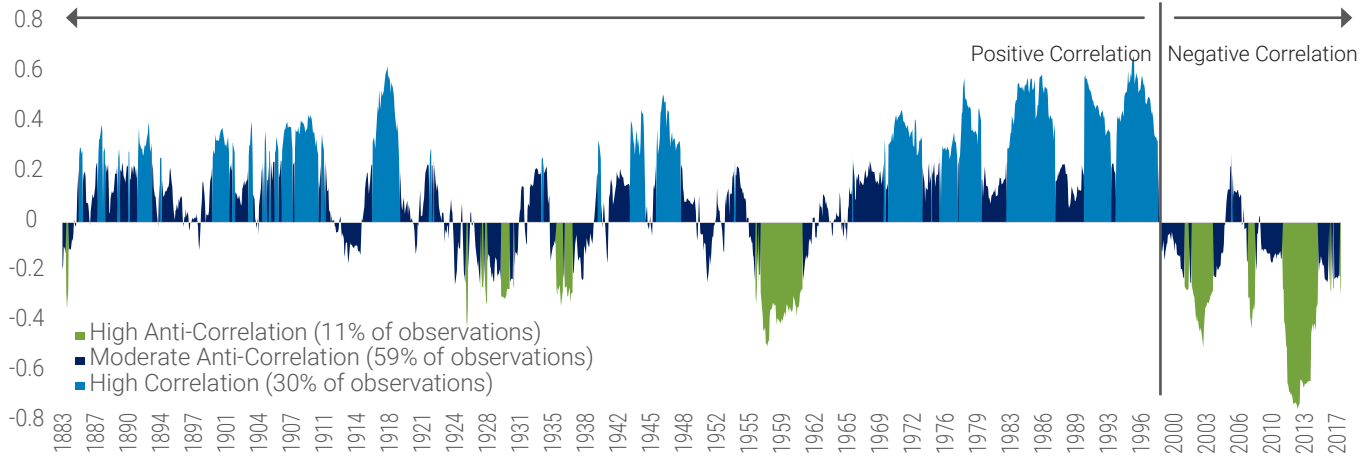
Source: Veripath analytics

WHAT IS THE FUTURE FOR 60/40 PORTFOLIOS? WHAT'S NEXT FOR INVESTORS?

The primary objective of the efficient frontier is to build a portfolio of assets that maximizes returns while maintaining a specified level of risk. In this context, the performance of individual assets is subordinate to the overall portfolio's performance. Crucial to this collective risk-adjusted approach is the presence of sustained, negative cross correlations.

At a fundamental level, this principle underpins the construction of 60/40 portfolios. However, it's worth noting that the negative cross-correlation between stocks and bonds is not an invariable phenomenon, as losses in the stock market and bond market have not consistently offset each other over the last 100+ years. Still, investors have built a portfolio framework with this as the core premise, and it has worked for decades. If there were to be a sustained shift away from negative correlation, portfolio construction models would be forced to make wholesale changes.

Chart 7: Relationship between the 10yr UST Yield and Domestic Equity Earnings Yield 3-year rolling correlation (monthly data – 1885 to 2015)



Source: Artemis Capital Management LP

In addition, the behaviour of 60/40 portfolios varies materially across different inflation regimes particularly when compared against alternative investments. Inflation and, worse, stagflation, are highly punitive to the 60/40 strategy. Inflation has been something that investors could largely ignore for the last two decades but this may be changing.

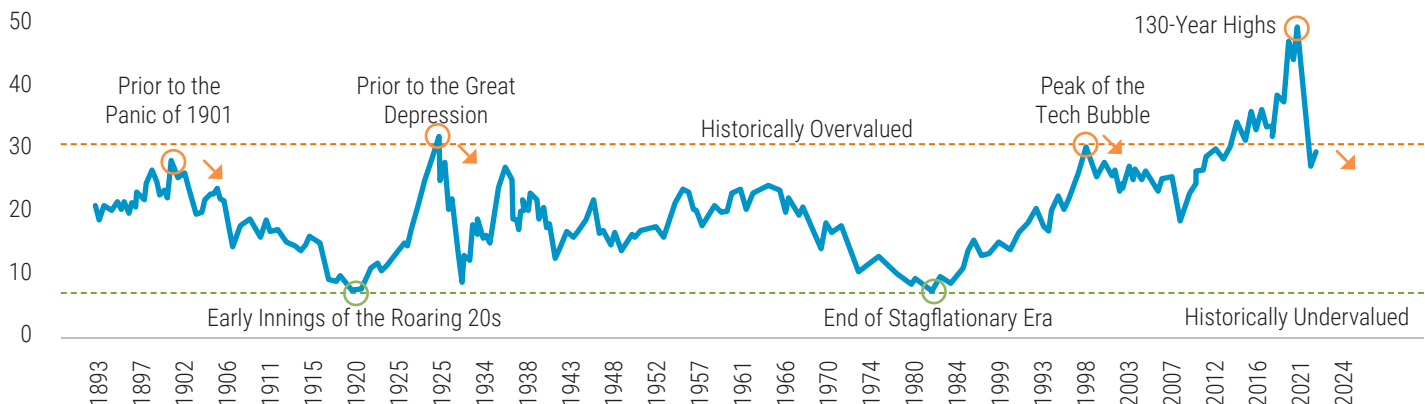
Table 2: Global Asset Performance by Inflation Environment

	Sharpe Ratio			Excess Return (Ann)		
	Stagflation	Other Periods	All Periods	Stagflation	Other Periods	All Periods
Frequency of Environment	18%	82%	100%	18%	82%	100%
Assets						
Inflation-linked Bonds	1.02	0.05	0.57	4.5%	2.2%	2.6%
Gold	0.67	0.10	0.23	17.6%	1.8%	4.5%
Broad Commodities	0.58	0.17	0.28	10.5%	2.4%	4.1%
Nominal Bonds	-0.20	0.63	0.44	-1.2%	3.5%	2.5%
Corporate Spreads	-0.66	0.33	0.18	-3.1%	1.8%	1.0%
Real Estate	-0.68	0.63	0.38	-13.8%	11.8%	7.3%
Global 60/40 Portfolio	-0.70	0.82	0.49	-6.6%	6.5%	4.1%
Equities	0.72	0.67	0.39	-10.2%	8.6%	5.1%

Source: Bridgewater

Valuation also appears to be a concern for 60/40 portfolios at current interest rate and price levels.

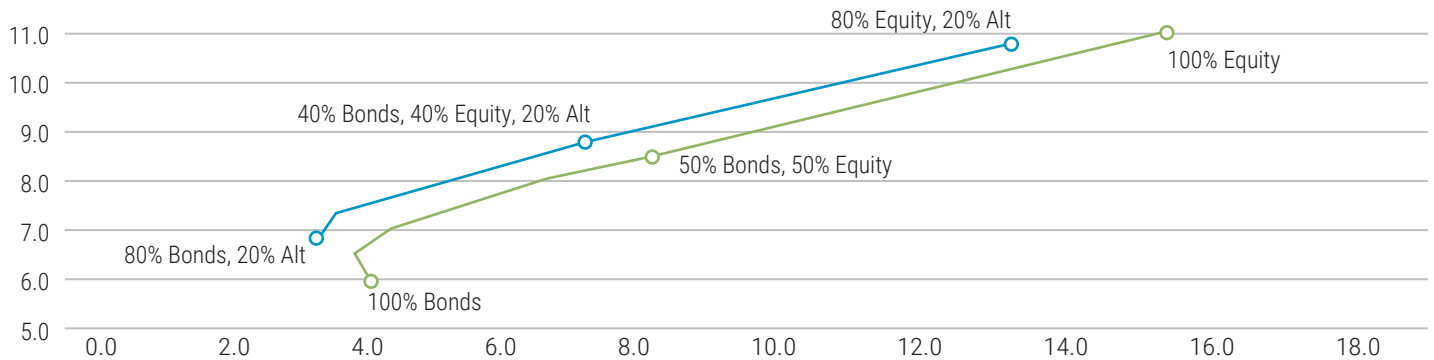
Chart 8: Valuation History of 60/40 Portfolios (Price to Earnings: (60% Weight of CAPE Ratio) + (40% Weight of Inverted 10-year Yield Treasuries))



Source: Crescat Capital

The traditional 60/40 portfolio approach appears to have correlation, inflation and valuation as headwinds currently. Separately, perhaps they could be ignored but in conjunction they may be difficult to overcome in the search for risk-adjusted returns. Can anything be done in mitigation? There is considerable evidence to conclude that the addition of private equity to 60/40 portfolios improves risk adjusted performance through a combination of diversification benefits and reduced volatility amongst other factors.

Chart 9: Stock/Bond Portfolio – Alternative Additions – Efficient Frontier (1990-2019)



Source: Bloomberg

The table below quantifies the impact of adding PE – **Sharpe Ratio increase up to 1**

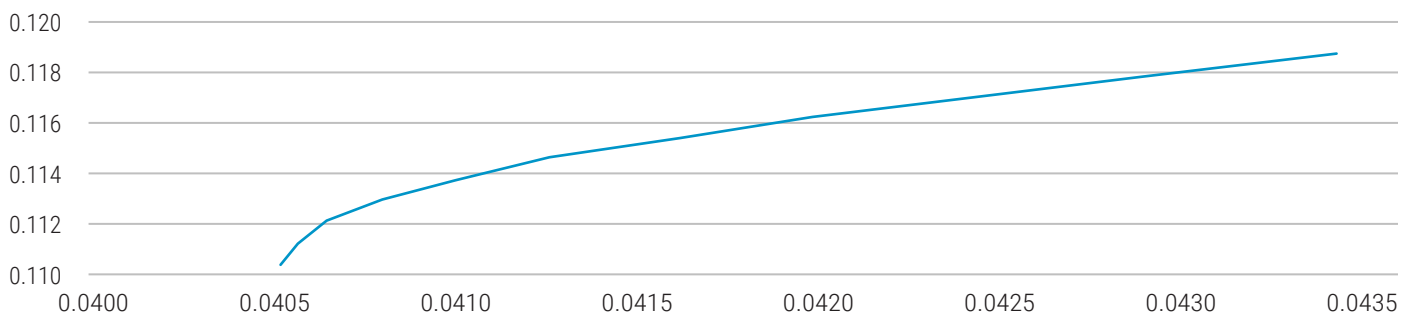
Table 3: Addition of PE to Portfolios

	Return	Volatility	Sharpe Ratio	Δ vs. 60/40	% Liquid Assets	Cash Yield
All Periods by Portfolio						
60/40	9.3%	12.7%	0.73	-	100%	2.6%
40/30/30	9.6%	9.6%	1.00	0.26	70%	3.6%
High Inflation by Portfolio						
60/40	1.5%	12.5%	0.12	-	100%	2.6%
40/30/30	4.3%	8.8%	0.49	0.37	70%	3.7%
Low Inflation by Portfolio						
60/40	11.0%	11.5%	0.96	-	100%	2.6%
40/30/30	10.5%	9.1%	1.16	0.21	70%	3.6%

Source: KKR

The table below quantifies the impact of adding farmland – **Sharpe Ratio increase up to 2**

Table 4: Efficient Frontier – 60/40 Equities Bonds – add 50/50 AB and SK farmland



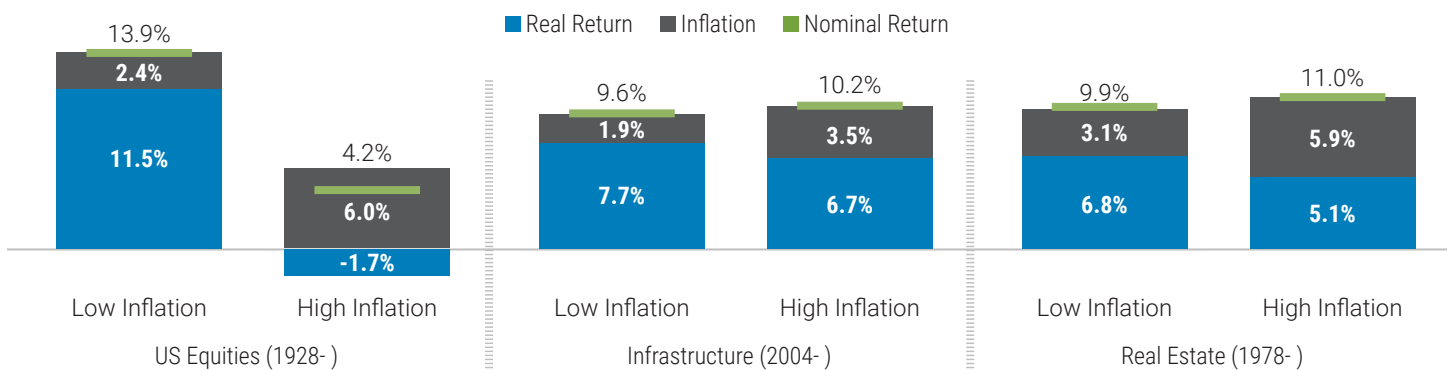
	Min Risk							Max Sharpe			
Mean	0.1105	0.1114	0.1122	0.1130	0.1138	0.1146	0.1155	0.11628	0.1171	0.1179	0.1187
St. Dev.	0.0405	0.0406	0.0406	0.0408	0.041	0.0412	0.0416	0.0419	0.0424	0.0428	0.0433
Sharpe	1.9875	2.0071	2.0224	2.0349	2.0445	2.0514	2.0558	2.057	2.0557	2.0521	2.0463
F	0.81	0.83	0.84	0.85	0.86	0.87	0.89	0.90	0.91	0.92	0.94
P	0.19	0.17	0.16	0.15	0.14	0.13	0.11	0.10	0.09	0.08	0.06

Source: Veripath, 10 years data 2007-2016

REAL ASSETS RETURNS TEND TO BE RESILIENT ACROSS MACRO CONDITIONS

"Resilience" is an amorphous concept but perhaps it is best described as consistent returns across various economic/macro climates, low return volatility with infrequent, drawdowns.

Table 5: Real Asset Resiliency versus Inflation – Real and Nominal Returns in High and Low Inflation



Source: KKR

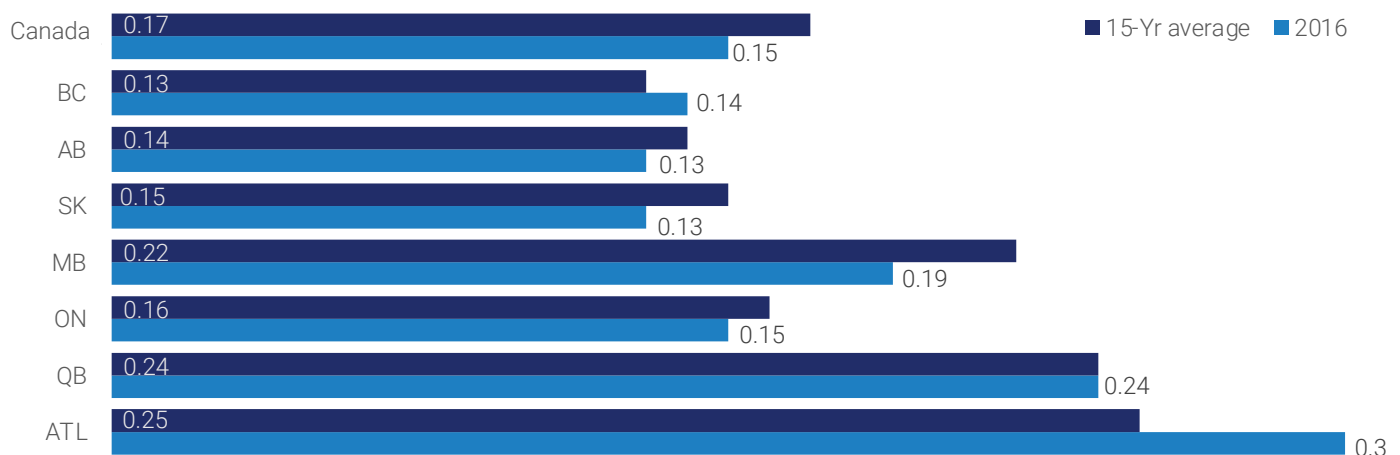
Table 6: Farmland Returns versus Inflation (1970 to 2021 – real rates)

	Up Year	Down Year
All Years	Average Appreciation (% pa)	9.60%
	Years (number)	45
	Years (percent)	87%
Real Rates <4%, >5%		
	Average Annual Appreciation (%)	10.30%
	Up Years (number)	35
	97%	50%

Source: Veripath analytics

Canadian farmland clearly exhibits "resilience" but why is this so? We believe low sector leverage is a contributing factor. Ignoring the leverage of any single investor, overall sector leverage tends to magnify sector drawdowns and act as a mechanism for the transmission of financial distress across asset classes. Collateral borrowing (LTV to land) has been low and stable in the Canadian farmland space for decades – ranging from ~15%-30% depending on province.

Table 7: Province By Province Farmland Collateral Leverage Levels



Sources: FCC, Veripath analytics, StatsCan

CONCLUSION:

Advocating the integration of real assets, particularly farmland, into traditional investment portfolios is well-founded especially with Canada's potential for stagflation. The efficient frontier of the 60/40 portfolio is rooted in the negative cross-correlation between stocks and bonds of the last 30 years and may require re-evaluation considering evolving market and sovereign debt dynamics. In addition, farmland investments, with its unique return behaviour offer a valuable alternative to traditional real estate, private equity (PE) and infrastructure diversifiers. The appeal of farmland becomes even more apparent when considering its distinct attributes, including non-depletion and perpetual crop production, along with inelastic demand for agricultural commodities, low stock-to-flow ratios, and complete consumption. Alternative investments such as Canadian farmland can enhance the efficient frontier of 60/40 portfolios, improving risk-adjusted returns.



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* This return data is provided for illustration purposes only. Past performance is not indicative of future results.

Note for Table 3 Efficient Frontier: Portfolio returns and volatility modeled using annual total returns from 1928 to 2021 for the S&P 500, from 1978 to 2021 for Real Estate, from 2004 to 2021 for Infrastructure, from 1928 to 2021 for Bonds, from 1981 to 2021 for Private Equity, and from 1987 to 2021 for Private Credit. Assumes continuous rebalancing of the portfolios. U.S. Equities modeled using the S&P 500 Index. Bonds modeled using a mix of 50% U.S. T-Bonds and 50% Baa Corp. Bond annual returns, computed historically by Aswath Damodaran (NYU Stern). Real Estate modeled using the NCREIF Property Levered Index. Private Infrastructure modeled using the Burgiss Infrastructure Index. Private Equity modeled using Burgiss North America Buyout Index. Private Credit modeled using the Burgiss Private Credit All Index. Cash yields modeled using annual data from 2000-2021 for all asset classes with the exception of Private Real Estate (2005-2021), Public Equity using S&P 500 12M gross dividend yield, Private Equity proxied using S&P Small Cap 12M gross dividend yield, Private Infra proxied using S&P Infrastructure 12M gross dividend yield from 2006 onwards and 2000-2006 back filled using S&P Utilities, Public Credit based on Bloomberg Aggregated Credit yield to worst, Private Credit using Cliffwater Direct Lending Index Income Return, Private Real Estate based on NCREIF NPI cap rate. Source: Burgiss, Aswath Damodaran, Bloomberg, NCREIF, KKR Portfolio Construction analysis.

Note for Table 5 Resiliency: Annual total returns from 1928 to 2021 for the S&P 500 from 1978 to 2021 for Real Estate and from 2004 to 2021 for Infrastructure. Real returns calculated as $[(1+\text{nominal return})/(1+Y/y \text{ Inflation}) - 1]$. Inflation component of the asset class return calculated as the difference between nominal and real return over the given period of time. U.S. Public Equities modeled with S&P 500 Index. Private Infrastructure modeled using the Burgiss Infrastructure Index. Real Estate modeled using the NCREIF Property Levered Index. Data as at March 31, 2023. Source: Burgiss, NCREIF, Bloomberg, KKR Global Macro, Balance Sheet & Risk analysis.