GEORGIAN
CAPITAL PARTNERS

Brookfield Asset Management Inc.
Letter to Shareholders – Q4 2016

Attached is a portion of an excellent letter to shareholders, specifically discussing management's outlook for the 'Market Environment' and 'Interest Rates'.

We agree with this overall assessment, i.e. that rising rates are likely and this implies better business – not translating to falling equities. This is particularly relevant to our growing dividends discipline and our holdings in financials / REITS.

Comments or questions welcome, as always.

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Market Environment

Despite all the political turmoil, most of the economies in which we participate are doing well, or are recovering. This has set the backdrop for a very constructive environment for us to invest in.

In the United States, we continue to believe, as we have for years, that interest rates will grind upwards to the 3% to 4% range. We have not changed our overall view with the election of a new government. We do, however, believe that we may get to the top end sooner than we otherwise might have expected, and that we might stretch the top end of former expectations before we hit a recession and the cycle starts over. But, should interest rates climb faster, it also means that growth is stronger than we would have otherwise expected. In this environment, all of our investments should also do better.

Europe and the United Kingdom have extremely low interest rates, and it looks like these will exist for some time, given the political turmoil, demographics and the underlying economies of the various countries. Despite this, we are finding many investments that can earn high leveraged cash returns, due to the correspondingly low borrowing rates.

South America is recovering slowly, following the shock of low commodity prices and the unwind of the excesses from the boom. We believe Brazil has bottomed, but the political aftershocks of the government investigations are still being worked through. Chile, Colombia and Peru, while great countries, are also each dealing with their own set of discrete issues. From an investment perspective this has, and continues to, present us with great opportunities in all of these countries.

India has made tremendous strides with its economy and recently reduced interest rates for the first time in this cycle. Despite this, the loan stress across the bank system needs to be worked through, and we are therefore being presented with great opportunities across all of our businesses. We are also using our Indian operations to continue to expand our base in the Gulf region. We have found that our deep investor relationships are proving extremely helpful and that our operating skills are welcomed.

China is a flashpoint for most economic prognosticators, but on the ground they continue to build out the greatest economic transformation ever undertaken in the world. We believe that they will be successful, but these transformations never go in a straight line. As a result, we are being very disciplined as we build our operations and investment strategies. We continue to find interesting ways to invest, and have also made great strides in partnering with world-class financial institutions and institutional partners in the region. These opportunities in both investing and fundraising should continue for years.

Interest Rates

For years we have been operating with the expectation that interest rates will increase in the United States. Our working assumption has been that the economy was getting stronger and that eventually interest rates would be able to rise as a result.

With rates having been virtually zero in the U.S. for seven years, a 1% or 2% increase in interest rates on the short or long end of the treasury yield curve means very little to a long-term return on a real asset investment. We have assumed for years that a 10-year treasury would have a 3% to 4% yield, and we continue to base all of our investment decisions on this.

The 10-year rate has now increased to circa 2.5%, but it is worth remembering that it is almost identical to where it was a year ago. At that time, everyone seemed to be worried about deflation; now the concern is about inflation. More important, in this cycle there have been very few sophisticated lenders or acquirers of real estate or infrastructure that have had a different view on rates, so cap rates have been stubbornly high relative to interest rates for one specific reason: that everyone knew interest rates were going up and no one has been willing to reduce cap rates to levels that matched the unduly low interest rates.

Our business is positioned to thrive in a higher interest rate environment; there are three simple reasons for this. First, and most important, we own "real return" assets that increase their cash flow generating capacity over time, either through contractual rights, our ability to operate them better, or an expansion of the operation. These enhancements should far outpace any extra interest costs, in particular in a more inflationary environment. Second, we generally earn total returns on equity of 10% to 20%. This is much greater than treasury yields and therefore a few percentage increases aren't material. And third, much of our debt is fixed rate debt; therefore, cash flows until maturity of that debt will not change at all.

We still believe that the odds are currently stacked heavily in favour of lower-than-usual interest rates in the U.S. for the medium term, if not longer. With $50 trillion of savings in the world that need to earn a return and rates in many parts of the world continuing to be very low, these savings are increasingly targeted at the returns and dependability that come from investments in the U.S. This should keep rates down for a while.