

An aerial, high-angle photograph of a cable-stayed bridge spanning a body of water. The sun is low on the horizon, creating a warm, golden glow and long shadows. The bridge's two tall, white, A-frame towers are prominent, with numerous cables fanning out to support the deck. Several vehicles, including cars and a truck, are visible on the bridge deck. The water below is calm, reflecting the light from the sky.

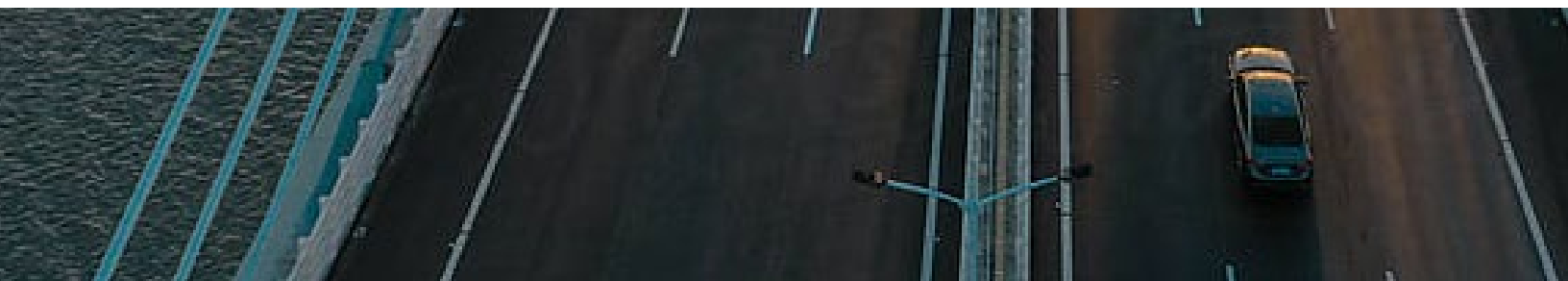
INVESTMENT MENU DESIGN

# The Real Deal

**Can diversified real assets investments help your participants over the long term? Three key questions to consider.**

It is no surprise that effective diversification remains one of the most useful tools plan sponsors have to help strengthen potential retirement outcomes for participants. So why do many participants still remain poorly diversified?

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The vast majority of US defined contribution (DC) assets have been invested in target date funds (32.8%), traditional US equities (32.8%), stable value (10.0%), and US fixed income (5.9%). However, only 1% of DC assets are invested in expanded “portfolio diversifier” categories such as Treasury Inflation-Protected Securities (TIPS), real estate, and alternatives strategies.<sup>1</sup> That’s in sharp contrast to similar retirement plans abroad, such as Australia’s more developed DC system that, on average, held alternative

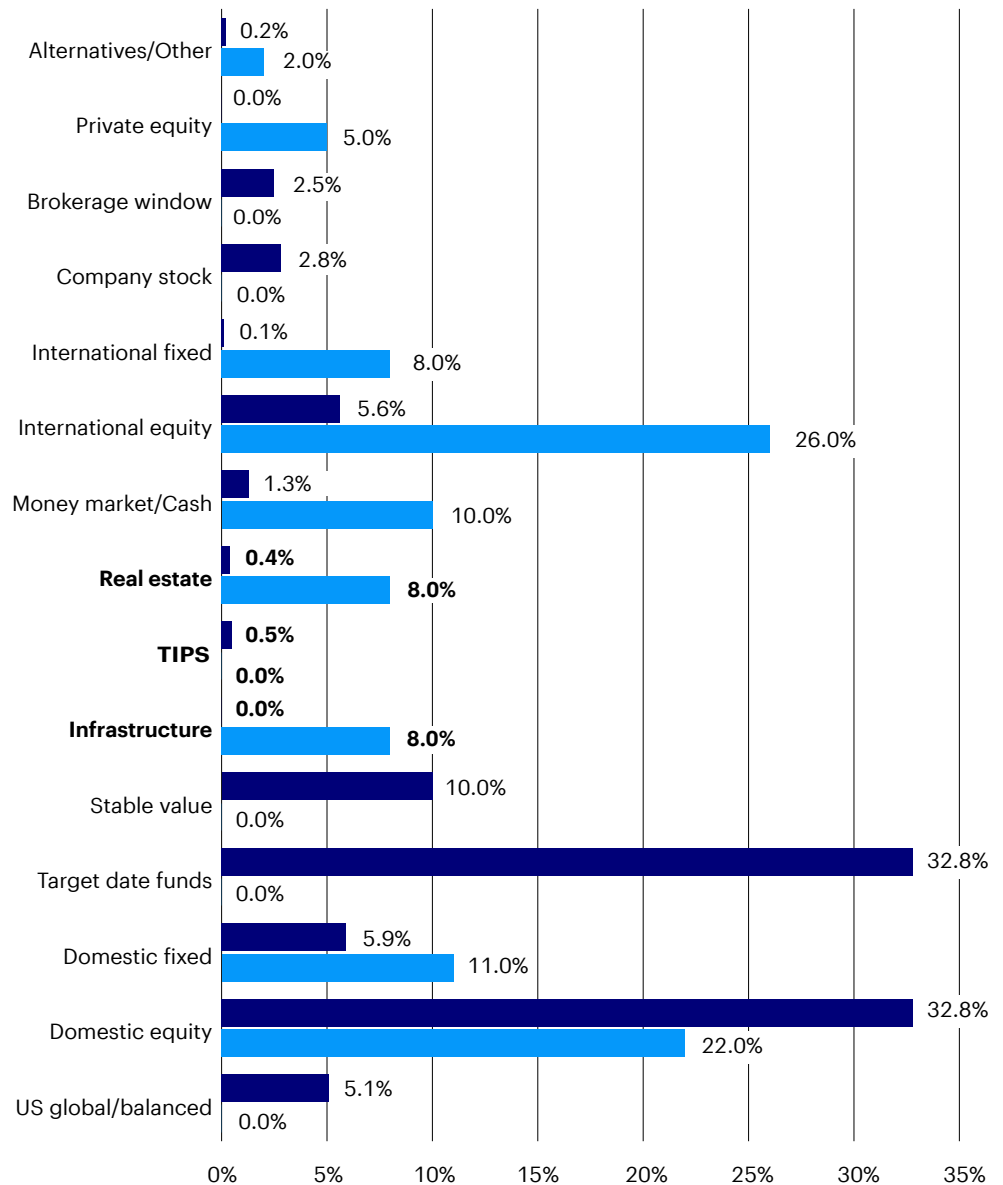
allocations of approximately 22% as of June 30, 2022.<sup>2</sup>

Real assets, in particular, may offer diversifying strategies and potentially tighten the range of outcomes. Today, plan sponsors and their advisors can choose from a range of diversified real assets solutions to help offer participants an efficient way to tap into this compelling set of diversifiers, which can be packaged together in one easy-to-access, professionally managed investment solution.

### US vs. Australia: DC plan asset allocation

As of June 30, 2022

■ US<sup>1</sup> ■ Australia<sup>2</sup>





Only 1% of US DC assets are invested in alternative categories, including real assets, versus 22% of Australian DC plans.

### The threat of inflation on retirement portfolios

Low inflation had been the norm for years, but with higher, unprecedented inflation that we haven't seen in 40 years, adding an allocation to a diversified real assets strategy may help provide a degree of protection from the potentially erosive effects of higher inflation.

### Defining real assets

Broadly speaking, real assets are typically defined as value-generating tangible assets or investment securities closely linked to them, where investment value is based on the asset's underlying characteristics and overall supply/demand dynamics. Unlike traditional financial assets, such as stocks and bonds, real assets are things such as property, office buildings, water systems, communication networks, cattle, oil and precious metals.

Real assets investments have long been used in institutional portfolios to help expand diversification, as they may perform well when traditional stocks and bonds have lagged. The category covers a wide range of investments, including global infrastructure, real estate and commodities. TIPS are also frequently included in diversified real assets portfolios, given their link to inflation.

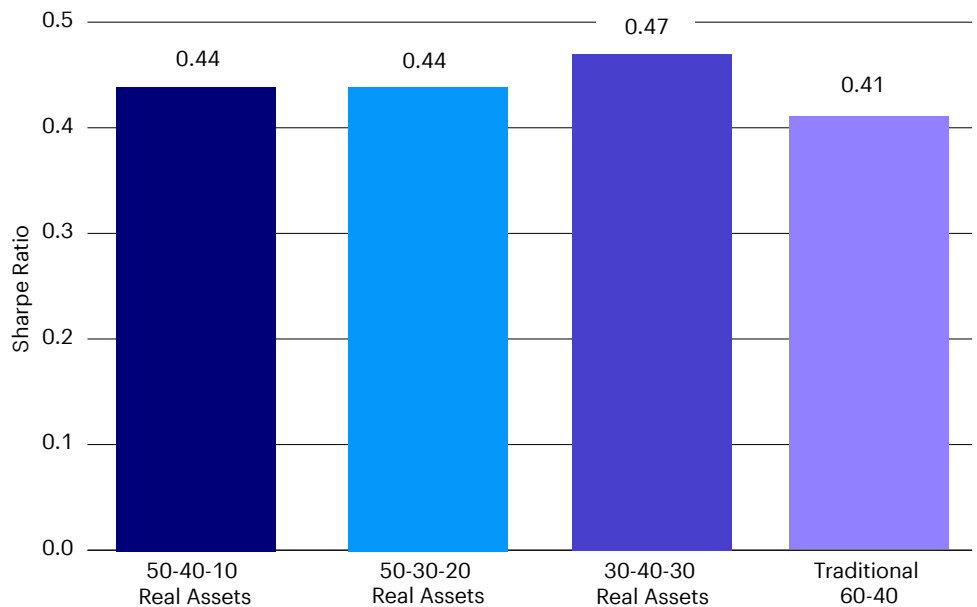
### Compelling investment characteristics

Real assets have historically offered potentially three key investment benefits:

- **Income:** Significantly higher income levels than global equity and fixed income alternatives<sup>3</sup>
- **Diversification:** Moderate correlation to broad equities that may provide a hedge against inflation<sup>4</sup>
- **Returns:** Historically attractive absolute total return and risk-adjusted performance

Working together, these potentially additive attributes may help fill the diversification need in many participant portfolios, diversifying risk and improving long-term overall return potential.

### Enhancing risk-adjusted performance through real assets exposure



Zephyr Style Advisors. Data from December 31, 1995, through June 30, 2022. Equities represented by MSCI World Index. Fixed income represented by Bloomberg Global Aggregate Bond Index. Real assets are an equal-weight custom index made up of real estate, commodities, infrastructure and natural resource equities. Real estate represented by FTSE Nareit Equity REITs Index for January 1996 through February 2005 and then FTSE EPRA/NAREIT Developed Real Estate Index for March 2005 through current. Natural resource equities represented by 50% Dow World Oil Index and Gas & 50% Dow World Basic Materials Index for January 1996 through May 2008 and S&P Global Natural Resources Index from June 2008 through current. Infrastructure represented by 50% Alerian MLP Index and 50% Dow Jones World Utilities for January 1996 through July 2008 and Dow Jones Brookfield Global Infrastructure Index for August 2008 through current. Commodities represented by S&P GSCI Index for January 1996 through July 1998 and then Bloomberg Commodity Total Return Index for August 1998 through current.

# Are real assets right for your plan? Here are three questions to ask.

## 1 What is your goal?

Diversified real assets strategies can be structured differently to meet various objectives. The two primary goals typically used for DC plans are either inflation-sensitive or defensive portfolios. The approach can depend on a variety of factors, including participant demographics and how the strategy fits within the investment menu.

## 2 Which categories of real assets should be included?

The strategic allocation in areas such as global infrastructure, real estate, commodities, TIPS and natural resources equities is based on the manager's long-term risk/reward outlook and correlation for each segment. Some managers also implement active tactical tilts to these longer-term allocations in an effort to take advantage of shorter-term market movements, such as supply shocks or changes in demand.

How various strategies approach each segment can also differ. For example, does the strategy pursue an active- or passive-management style? Other segment-specific considerations include:

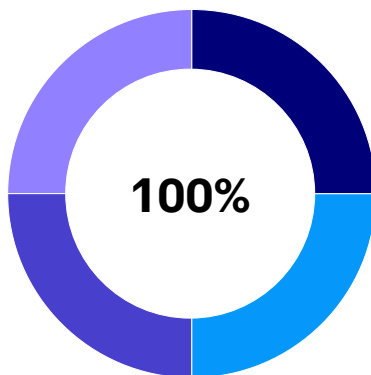
- **Global infrastructure:** This has been an area of increasing investor focus due to the growing global demand for infrastructure. However, plan sponsors should evaluate the types of securities and underlying sector and regional exposures, as the associated investment characteristics can be dramatically different. Traditionally, infrastructure investments involved low liquidity and long lockups. However, infrastructure securities that trade on exchanges make this more feasible for DC plans.
- **Real estate:** A manager may invest in publicly listed real estate investment trusts (REITs) in order to

seek growth of capital and current income. REITs allow investors to gain exposure to commercial property with relatively low minimum investment thresholds and daily liquidity. An actively managed REIT portfolio can potentially benefit from taking advantage of performance dispersion across different geographies and property types.

- **Commodities:** This segment, in particular, can be highly volatile on its own but can be valuable within a multi-asset portfolio. With commodities, an active risk-managed approach may improve the allocation's overall risk/reward profile.
- **TIPS:** While often underutilized and misunderstood by participants as a standalone investment, TIPS can help provide protection from certain types of inflation and add ballast to a real assets portfolio.

A multifaceted approach to real assets can bring together potentially complementary characteristics to help limit the range of investment outcomes and smooth out long-term performance. But it is important to understand how managers approach portfolio construction.

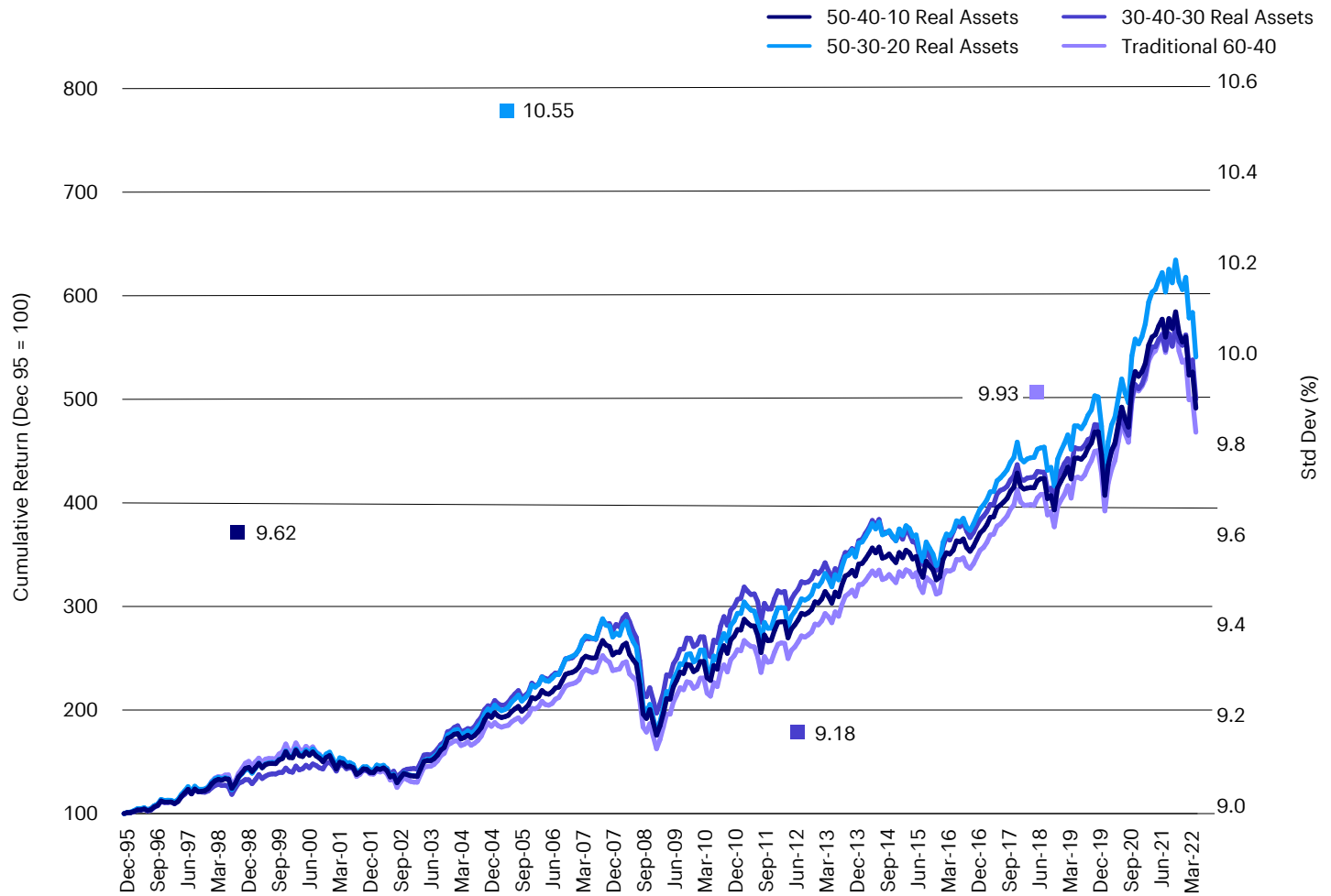
### Hypothetical real assets portfolio (%)



■ Global Listed Infrastructure	25.00
■ REITs	25.00
■ Active Commodities	25.00
■ TIPS	25.00

For illustrative purposes only. This information is not intended as a recommendation to invest in a specific asset class or strategy.

**Adding listed real assets to a traditional 60/40 portfolio has historically raised the return profile without materially increasing portfolio standard deviation**



Performance as of June 30, 2022. Real Assets are represented by the S&P Real Assets Equity Index. Equity within the portfolio is represented by MSCI World Index. Fixed Income is represented by Bloomberg Global Aggregate Bond Index. Our indices are rebased to 100, using our starting point (12/31/1995). Standard deviation is represented by the squares in the chart and is color-coded to the corresponding portfolio allocation. Past performance is not indicative of future results. An investment cannot be made into an index. The chart is shown for illustrative purposes and does not predict or depict the performance of any particular investment.

### 3 How can plans drive stronger participant adoption?

There are two main ways plan sponsors and their advisors can effectively implement a diversified real assets strategy into their plan lineups:

- A streamlined core menu option.** Among large plans, 34.1% offer TIPS as a standalone option (with an average allocation of 1.4% when offered), and 21.2% of plans include a real estate option (with an average allocation of 2.0% when offered)<sup>1</sup>. While these options are fairly prevalent, utilization is low. It's widely understood that too many options within an investment menu can be confusing to participants, which is why a more effective solution may be replacing these

standalone options with one professionally managed, diversified real assets portfolio – providing even greater potential diversification while helping to simplify participant decision-making.

- Within target date and target risk funds.** One diversified strategy can make it easier to implement real assets as a component within customized and off-the-shelf target date and target risk funds.

Ultimately, the best way to drive constructive behavior is to make it easy for participants to tap into the potential benefits diversified real assets may provide.

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## Next steps

Diversified real assets solutions can offer an effective lineup addition for plan sponsors looking to enhance diversification and help narrow the range of participant outcomes. Look at the plan's current investment allocations. Where are participants allocated?

How diversified are their portfolios? What types of portfolio diversifiers are available on the investment menu? Are there missing segments or opportunities to drive more constructive behavior? If so, a diversified real assets solution may be a smart addition.

1. Callan DC Index, data as of June 30, 2022.
2. ASFA, Superannuation Statistics August 2022, data as of June 30, 2022
3. S&P Real Assets Equity Index yielded 4.1%. Global equities represented by MSCI World Index yielded 2.2%. Global bonds represented by Bloomberg Global Aggregate Bond Index yielded 2.9%. Source: Bloomberg L.P. as of June 30, 2022. Past performance is not indicative of future results. An investment cannot be made into an index.
4. Correlation between real estate, infrastructure, metals and mining, energy, agriculture and timber as represented by FTSE EPRA Nareit Developed Index, Dow Jones Brookfield Global Infrastructure Index, MSCI World Metals and Mining Index, MSCI World Energy Sector Index, S&P Global Agribusiness Equity Index and S&P Global Timber & Forestry Index compared to the MSCI World Index: 0.85, 0.83, 0.73, 0.73, 0.81 to 0.86 respectively from December 2003-June 2022. The FTSE EPRA Nareit Developed Index is designed to represent general trends in eligible real estate equities worldwide. The Dow Jones Brookfield Global Infrastructure Index is designed to measure the performance of pure-play infrastructure companies domiciled globally. The MSCI World Metals and Mining Index is composed of large and mid-cap stocks across 23 Developed Markets (DM) countries classified in the Metals & Mining industry according to the Global Industry Classification Standard (GICS®). The MSCI World Energy Index is designed to capture the large and mid-cap segments across 23 Developed Markets (DM) countries classified in the Energy sector as per the Global Industry Classification Standard (GICS®). The S&P Global Agribusiness Index includes 24 of the largest publicly-traded agribusiness companies from around the world. The S&P Global Timber & Forestry Index is comprised of 25 of the largest publicly traded companies engaged in the ownership, management or the upstream supply chain of forests and timberlands. The MSCI World Index is a market-cap weighted stock market index of 1,540 companies throughout the world. An investment cannot be made directly into an index.



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A target date fund identifies a specific time at which investors are expected to begin making withdrawals, e.g., now, 2025, 2030. The principal value of the fund is not guaranteed at any time, including at the target date.

A target risk fund is a type of asset allocation fund that holds a diversified mix of stocks, bonds, and other investments to create a desired risk profile. The fund manager of a target risk fund is responsible for overseeing all the securities owned within the fund to ensure that the level of risk is not greater or less than the fund's target risk exposure.

**Correlation** is the relationship between distribution of returns between two data series.

**Sharpe ratio** is the average return earned in excess of the risk-free rate.

**Standard deviation** measures the degree to which the performance of a portfolio varies from its average performance during a specialized period.

Investment in infrastructure-related companies may be subject to high interest costs in connection with capital construction programs, costs associated with environmental and other regulations, the effects of

economic slowdown and surplus capacity, the effects of energy conservation policies, governmental regulation and other factors.

Inflation-indexed securities generally fluctuate in response to changes in real interest rates, and the Fund's income from its investments in these securities is likely to fluctuate considerably more than income distributions on its investments in more traditional fixed income securities.

Investments in real estate-related instruments may be affected by economic, legal, or environmental factors that affect property values, rents or occupancies of real estate. Real estate companies, including REITs or similar structures, tend to be small and midcap companies and their shares may be more volatile and less liquid.

Obligations issued by US Government agencies and instrumentalities may receive varying levels of support from the government, which could affect the fund's ability to recover should they default.

Commodities may subject an investor to greater volatility than traditional securities such as stocks and bonds, and can fluctuate significantly based on weather, political, tax, and other regulatory and market developments.

**The S&P Real Assets Equity Index** is a static-weighted return of investable and liquid equity-indexed components that measures the performance of real return strategies that invest in listed global Property, infrastructure, natural resources, and timber and forestry companies.

**The MSCI World Index** is a broad global equity index that represents large and mid-cap equity performance across all 23 developed markets countries. It covers approximately 85% of the free float-adjusted market capitalization in each country.

**The Bloomberg Global Aggregate Bond Index** is a flagship measure of global investment grade debt from 24 local currency markets. This multicurrency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.

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