

“REAL” ASSETS



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The past two decades of disinflation and declining interest rates have been a giant tailwind for both stocks and bonds. However, expectations for inflation have increased recently, and rising inflation could present a hurdle in years to come.

Inflation tends to be cyclical, exhibiting long-term rising and falling trends. Currently, global re-inflation appears to be taking hold as evidenced by:

- China's insatiable appetite for goods
- The U.S. dollar's recent decline and continued weakness, while "commodity" currencies have broken out of a secular downtrend
- Global constraints in energy and manufacturing supplies are more pronounced

As stocks and bonds generate meager returns in periods of stable or rising inflation, many investors are searching for ways to add value to their portfolios while at the same time controlling volatility.

Coincidentally, many investors have little exposure to inflation-protection strategies within their portfolios.

Those looking for ways to achieve real returns over inflation may wish to consider asset classes such as inflation-protected securities, real estate, commodities, and basic resource equities, all of which have historically performed well in periods of accelerating inflation and have provided a source of additional diversification relative to standard benchmarks.

Multiple strategies can be combined to include all of the real assets mentioned. A reasonable target would be to achieve positive real returns with an overall portfolio risk similar to that of longer dated U.S. Treasury Inflation Protected Securities (TIPS). Specifically, a combination of multiple real asset strategies using an index approach can provide efficient, broad-based exposure to U.S. TIPS, REITs, commodities, and natural resource stocks. Exchange-traded funds specific to these assets classes have become more popular as a means to accomplish this strategy.

The underlying components of a portfolio that holds real asset investments might include the following:

U.S. TIPS

Treasury Inflation Protected Securities provide broad exposure to the U.S. Treasury inflation protected securities market. The dollar payments on these securities are adjusted according to actual inflation over the life of the bonds.

REITs

Real Estate Investment Trusts, or REITs, can provide broad exposure to the U.S. commercial real estate market. There

are a variety of REITs that specialize in office, apartment, retail and industrial properties. The rents and net profits generated by these properties generally increase along with other prices.

Commodities

A commodities index that provides broad exposure to the global commodities market and invests in futures in five major commodity groups, including energy, agriculture, industrial metals, livestock, and precious metals. Commodity prices generally respond quickly to economy-wide shocks and are considered to be leading indicators of inflation.

Global Natural Resource Stocks

Finally, a group of natural resource stocks that provides broad exposure to global natural resource equities, specifically the four basic resource industry groups within the MSCI World Index. These are oil and gas, energy equipment and services, metal and mining, and paper and forest products.

In most cases, the inclusion of real assets can complement a diversified asset allocation strategy. For any investor, the future benefits of investing in real assets may include attractive risk adjusted returns, low volatility, and low correlation with other traditional asset classes. On a prospective basis, benefits may include ample current income, as well as an inflation hedge, especially when market returns are expected to be modest.



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- There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not ensure against market risk.