

Fund Focus

# FlexShares Real Assets Allocation Index Fund

**NO ASSEMBLY REQUIRED**

*For investors seeking a packaged real asset strategy including global infrastructure, real estate and natural resource equities*

Adding real asset classes such as commodities, real estate, agricultural land and oil to a portfolio may provide a combination of equity-like capital appreciation and bond-like yields, as well as possible inflation hedging protection. However, investors may find themselves overwhelmed by the sheer number of real asset investment opportunities. What's more, each real asset class offers a different mix of advantages and considerations, making it a challenge to assemble a real asset strategy that matches an investor's objectives.

In this paper, we discuss how adding real asset exposure to a portfolio may help dampen inflation risk while providing income and long-term capital appreciation potential. We then explain how the FlexShares Real Assets Allocation Index Fund (ASET) employs a "fund of funds" model to provide broad, balanced exposure to real assets, while seeking to minimize volatility.

**THE CHALLENGE OF CREATING AN OPTIMAL REAL ASSETS PORTFOLIO**

Many investors are interested in using real asset classes like commodities, real estate and natural resources to diversify their investment portfolios. The reason is that real assets offer different risk and return characteristics than the traditional asset classes of stocks, bonds and cash.

They also may provide several advantages, including:

### Dampening inflation risk

Real assets have historically responded favorably in rising inflationary or expanding economic cycles. This tendency makes them useful to investors seeking to reduce the effect of inflation on their long-term returns.

### Stable, bond-like yields

Real estate and other real asset classes that may generate steady, predictable cash flows also tend to provide strong dividend payments to investors.

### Equity-like capital appreciation

Growing national investments in areas such as infrastructure investments and natural resource extraction may lead to continued investments. The large size and long-term nature of these projects have the potential to produce long-term returns.

While some investors choose to target a specific area of the real asset investment landscape, others may prefer broad exposure to the entire range of real asset classes. The emergence of exchange-traded funds (ETFs) has enabled individual investors to invest in real assets on a class-by-class basis in a cost efficient manner. We believe, however, choosing the right mix of investments to maximize the potential advantages of broad real assets strategy may be complicated, resulting in sub-optimal portfolios. Our opinion is that the wrong mix of real assets may lead to inadvertently increasing a portfolio's overall volatility. Our research finds that a professionally managed, optimally balanced real assets fund may offer an easier way to capture the benefits of these investments.

### THE FLEXSHARES SOLUTION: A TURNKEY REAL ASSET FUND

The FlexShares Real Assets Allocation Index Fund (ASET) is an ETF that seeks to provide broad, diversified exposure to real assets by tracking a custom index, the Northern Trust Real Assets Allocation Index.<sup>1</sup> Northern Trust Investments Inc. (NTI) is the investment adviser for FlexShares ETFs.

The underlying index is composed of three FlexShares ETFs:

#### NFRA

The FlexShares STOXX Global Broad Infrastructure Index Fund (NFRA), which seeks to offer a balanced exposure to global infrastructure investments and uses a bottom-up supply chain analysis to seek a broad range of global infrastructure companies.

#### GQRE

The FlexShares Global Quality Real Estate Index Fund (GQRE), which seeks to offer broad exposure to the global real estate market while deploying a rules-based multi-factor selection methodology to help seek enhanced diversification and potentially mitigate systemic risk.

#### GUNR

The FlexShares Morningstar Global Upstream Natural Resources Index Fund (GUNR), which seeks to offer broad exposure to companies involved in extracting natural resources and transporting them to processors, including those involved in timber and water.

NTI uses a methodology based on modern portfolio theory<sup>2</sup> to optimize the three underlying funds. This methodology involves analysis of the volatility of the underlying securities held by the three ETFs to determine the optimal proportion of each fund in the final portfolio, with an eye toward minimizing volatility and reducing risk.

Finally, NTI rebalances the weightings of each ETF in the index annually. It also applies constraints to help ensure that exposure to each fund is no lower than 10% and no higher than 50%.

## REAL ASSET DIVERSIFICATION, PROFESSIONALLY OPTIMIZED

We believe that the ETFs used to create the Northern Trust Real Assets Allocation Index offer efficient exposure to the potential benefits of real asset investing. For example:



Investments in upstream natural resources may help reduce the risks of inflation, as we believe the price of natural resources tends to move in tandem with inflation.



Natural resources and real estate assets may provide stable, bond-like income potential, since our opinion is that these assets may provide predictable cash-flows and dividends.



Global infrastructure investments, including those in emerging markets, may provide equity-like long-term capital appreciation.

Furthermore, it is our view that NTI's index methodology offers an optimized weighting of these real asset classes based on the expertise of experienced investment managers. This approach aims to capture the advantages of real asset investing in a balanced way, while minimizing volatility, in a streamlined core real asset holding.



### CONCLUSION

Adding real assets to a portfolio may provide inflation hedging protection, income potential and capital appreciation. But it can be difficult for individual investors to build an optimally diversified real asset portfolio to achieve these goals while also minimizing volatility.

The FlexShares Real Assets Allocation Index Fund (ASET) seeks to offer a turnkey core real asset holding that captures these advantages while minimizing volatility and risk. Its portfolio comprises three separate FlexShares real assets ETFs, each designed to optimize exposure to specific areas of the real asset investment landscape, assembled according to a methodology that seeks to minimize volatility without constraining return.

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### FIND OUT MORE

The FlexShares approach to investing is, first and foremost, investor-centric and goal oriented. We pride ourselves on our commitment to developing products that are designed to meet real-world objectives for both institutional and individual investors. If you would like to discuss the attributes of any of the ETFs discussed in this report in greater depth or find out more about the index methodology behind them please don't hesitate to call us at 1-855-FlexETF (1-855-353-9383).

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## FOOTNOTE

- 1 The Northern Trust Real Assets Allocation Index is designed to provide a core real asset allocation that addresses inflation hedging, diversification and income needs with a focus on reducing volatility.
- 2 Modern portfolio theory (MPT) is a theory on how risk-averse investors can construct portfolios to maximize expected return based on a given level of market risk. Harry Markowitz pioneered this theory in his paper "Portfolio Selection," which was published in the Journal of Finance in 1952.

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## IMPORTANT INFORMATION

**Before investing, carefully consider the FlexShares investment objectives, risks, charges and expenses. This and other information is in the prospectus and a summary prospectus, copies of which may be obtained by visiting [www.flexshares.com](http://www.flexshares.com). Read the prospectus carefully before you invest.**

### **Foreside Fund Services, LLC, distributor.**

An investment in FlexShares is subject to numerous risks, including possible loss of principal. Fund returns may not match the return of the respective indexes. A full description of risks is in the prospectus.

The FlexShares Real Assets Allocation Index Fund (ASET) is passively managed and primarily uses a replication strategy to track its underlying index. Use of a replication strategy creates tracking risk where the Fund's performance could vary substantially from the performance of the underlying index along with the risk of high portfolio turnover. The Fund is subject to commodity exposure risk, the risk of investing in economies that are susceptible to fluctuations in certain commodity markets. The Fund is subject to counterparty risk, which is the risk that counterparty to a financial instrument may default on its payment obligation to an Underlying Fund. Investments in foreign and emerging market securities involve certain risks such as currency volatility, political and social instability and reduced market liquidity. The Fund's investments are concentrated in the securities of issuers in a particular market, industry, sector or asset class. The Fund may be subject to increased price volatility and may be more susceptible to adverse economic, market, political or regulatory occurrences affecting that market, industry, sector or asset class. The Fund may also invest in derivative instruments. Changes in the value of the derivative may not correlate with the underlying asset, rate or index and the Fund could lose more than the principal amount invested.