Investing Strategies for Volatile Energy Markets

Natural resources and infrastructure strategies can help portfolios during energy price spikes, but investors should maintain a long-term perspective

Recent performance by natural resources and infrastructure investments have illustrated the important role these strategies can play in a diversified portfolio.

Surging oil prices following Russia's invasion of Ukraine in late February sparked broad-based stock selloffs around the world. Investors reacted immediately, concerned that limited energy supplies and higher costs could exacerbate inflation, then jumped back into stocks just as quickly when oil prices began ticking down.

This pattern of volatility driven by short-term swings in oil prices has continued since the start of the conflict, demonstrating the impact of oil prices on investment portfolios. But investors with more direct exposure to energy-related sectors through commodities and infrastructure strategies likely had a different experience — and may have different questions about what comes next.

Recent performance by natural resources and infrastructure investments have illustrated the important role these strategies can play in a diversified portfolio. But investors should also avoid the temptation to overreact to short-term conditions and make dramatic moves that can expose them to higher risk over the long term.

INFRASTRUCTURE STRATEGIES CAN PROVIDE PROTECTION IN VOLATILE MARKETS

Although infrastructure funds include investments related to the oil and gas industries, their returns typically aren't directly connected to the prices of those commodities. For example, oil and gas pipelines are paid based on the volume of product moving through their networks — regardless of commodity prices. Utilities that face higher prices for the fuels they use to generate electricity generally are allowed to pass those costs on to their rate payers, keeping their cash flow more predictable in volatile energy markets.

So while high energy prices are unlikely to produce excess returns for infrastructure strategies, they're also unlikely to suffer as much as other equity investments during market downturns sparked by surging oil prices. That's why infrastructure funds often serve as defensive strategies, particularly as a way of offsetting volatility elsewhere in a portfolio.

COMMODITY STRATEGIES MAY OFFER INFLATION HEDGES

One of the primary reasons investors choose real asset strategies is to provide an inflation hedge in their portfolios. Companies directly involved in extracting commodities like oil and gas from the ground — as well as agricultural products, metals, timber and water — should benefit when the price of these economic building blocks rises dramatically.

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The recent spike in oil and gas prices showed this principle in action: The energy component of the U.S. Consumer Price Index increased 32% year-over-year in March 2022*, which is translating into rising cash flow and profits for oil and gas producers. At the same time, natural resources strategies that invest in these companies have widely outperformed the broader market.

In the short term, natural resources strategies with exposure to oil and gas producers have been performing as expected in times of high energy prices and high inflation. In the medium term, the lack of excess production capacity in the global energy markets and the complexity required to accelerate the world's transition to a low-carbon economy may keep energy prices elevated — barring a recession or other macroeconomic catalysts that reduce demand.

INVESTING FUNDAMENTALS STILL APPLY

Despite the dramatic impact of recent energy price movements on the equity markets, investors should be cautious about making short-term, tactical movements in their portfolios. We believe that long-term investment success depends on proper diversification across an entire portfolio, as well as within the individual strategies used to achieve an investors' desired exposures.

For example, a commodities strategy heavily concentrated in oil and gas producers that may have delivered higher returns during February and March of 2022 is subject to higher risk of losses when demand for energy declines. A well-diversified natural resources strategy that includes exposure to other important sectors can provide the inflation-hedging and return potential that investors seek, without taking additional risks related to an energy sector that's still in the midst of a long-term transition.

Likewise, infrastructure strategies should balance investments across sectors to avoid concentration in energy-related industries like pipelines and utilities. Geographic diversification can also reduce risks related to regulations, political activity and natural disasters.

No one can predict what may cause the next energy shock, or how the economy may adjust to these events over the long-term. Choosing well-constructed, well-diversified real asset and infrastructure strategies can help investors increase the odds of achieving their goals under a broad range of circumstances.

For more on infrastructure and real asset investing, see our articles:

- Why You Should Consider Expanding Your Definition of 'Infrastructure'
- What's the Best Way to Invest in Real Assets?

For more on FlexShares' investing strategies, see our fund pages:

- FlexShares STOXX® Global Broad Infrastructure Index Fund (NFRA)
- FlexShares Morningstar® Global Upstream Natural Resources Index Fund (GUNR)

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).

DEFINITIONS

Cash flow refers to the net amount of cash and cash equivalents being transferred in and out of a company. Cash received represents inflows, while money spent represents outflows. A company's ability to create value for shareholders is fundamentally determined by its ability to generate positive cash flows.

S&P 500 is the Standard & Poor's 500 Index, is a float-weighted index, meaning the market capitalizations of the companies in the index are adjusted by the number of shares available for public trading of the 500 leading publicly traded companies in the U.S.

FOOTNOTE

* U.S. Bureau of Labor Statistics, Consumer Price Index News Release, March 10, 2022.

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. Read the prospectus carefully before you invest.

Foreside Fund Services, LLC, distributor.

Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

FlexShares Morningstar® Global Upstream Natural Resources Index Fund (GUNR) is passively managed and uses a representative sampling strategy to track its underlying index. Use of a representative sampling 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. It is subject to the global natural resource industry. As the demand for or prices of natural resources increase, the Fund's equity investment generally would be expected to also increase. Conversely, declines in demand for or prices of natural resources generally would be expected to cause declines in value of such equity securities. Such declines may occur quickly and without warning and may negatively impact your investment in the Fund. Investments in foreign market securities involve certain risks such as currency volatility, political and social instability and reduced market liquidity. To the extent that the Fund invests in Emerging markets, those investments may be subject to increased price volatility and may be more susceptible to adverse economic, market, political or regulatory occurrences affecting that country, market, industry, sector or asset class.

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