Why You Should Consider Expanding Your Definition of "Infrastructure"

A modern approach to this traditional investment strategy may help meet clients' goals for inflation-hedging and growth potential

For decades, we believe investors have used infrastructure stocks as a diversifying asset to hedge against inflation. While the role for infrastructure stocks remains as valid as ever, infrastructure projects themselves have evolved over time. In our opinion, an effective investing strategy should likewise evolve to encompass a more current definition of infrastructure.

Some infrastructure strategies may focus on traditional projects like roads, bridges, energy assets and water/waste management facilities. Today, though, critical infrastructure includes newer technologies like cellular towers and broadband networks, as well as so-called "social infrastructure," which includes health care facilities and privatized postal services.

Seeking infrastructure investment strategies that take this broader view of qualifying assets may help diversify portfolios across and within sectors, as well as around the world. This additional diversification may help improve the hedging characteristics of an infrastructure strategy, while potentially exposing investors to growth opportunities that exist in this evolving space.

DIVERSIFYING WITH MODERN PROJECTS TO AVOID SECTOR CONCENTRATION

Traditional infrastructure projects historically gain their inflation-hedging potential from the fact that they tend to be capital intensive, relatively monopolistic and subject to steady demand no matter the economic environment. These qualities may often translate into stable cash flows and the ability to pass cost increases on to customers.

However, because traditional projects tend to be concentrated in sectors like energy and utilities, infrastructure investment strategies may become overweight to those areas and exposed to additional risk. For example, a strategy with a concentration in energy projects may be overly sensitive to fluctuations in energy prices.

Broadening the scope of an infrastructure investment strategy may diversify holdings among new types of projects that may potentially offer the same inelastic demand and stable cash flows:

Many believe that access to broadband internet is emerging as a universal need in the modern world, similar to the push to provide clean water to all houses in the last century.

Governments in Germany, the U.K., Malaysia and other countries have privatized postal services, allowing investors to own a piece of that social infrastructure through publicly traded stocks.

Health care facilities are a rapidly growing investment opportunity as governments around the world look for private companies to help fill the gap between public health infrastructure and rising patient needs.

For investments in all these sectors, though, we believe it's important for a strategy to focus on established infrastructure projects—often called "brownfield activities." These existing assets may offer the kind of predicable cash flows that many investors have come to expect from their infrastructure stocks, compared to what some think are riskier investments in so-called "greenfield" projects like a new water desalination company.

IDENTIFYING INFRASTRUCTURE OPPORTUNITIES WHEREVER THEY ARE

To create sufficiently diversified portfolios, we believe that infrastructure strategies also need a construction methodology that looks broadly and deeply for the best opportunities. Investors may also want to focus on strategies that take a global approach. This may allow them to take advantage of countries where modern infrastructure projects—like privatized postal services—could be well established.

Targeting modern infrastructure may also require a more sophisticated way to identify companies that operate infrastructure assets. We believe that legacy infrastructure indices may not be the most efficient way to uncover investment opportunities, because many indices have historically been organized using top-down sector codes that classify common stocks.

Consider how this approach could create a challenge for investing in communication infrastructure:

Cellular tower companies and data center operators are often structured as real estate investment trusts (REITs) and classified as specialized REITs.

The specialized REITs category also includes operations like campgrounds, timberland and public storage facilities.

An investment strategy that used only top-down categorization might end up with exposure to these non-infrastructure projects, or else miss the opportunity to hold important communications assets.

Investors may benefit by looking for investment strategies with a systematic way to identify infrastructure projects beyond top-down sector categorization. For example, a strategy can use supply chain data analysis to help identify a company's business operations and quantify the revenue it generates from infrastructure projects versus other activities.

Given the ongoing evolution of infrastructure, investors should feel confident that the investing strategy they choose is exposed to both traditional assets and emerging opportunities that may become even more important in the future. By focusing on strategies with a global reach, a broad definition of infrastructure and a method for uncovering the right companies, investors may enjoy a more diversified portfolio that helps meet their goals for inflation hedging and growth potential in a long-term equity strategy.

For more ideas on adding inflation-hedging components to investment portfolios, read:

Maximize the Effectiveness of Inflation-Hedging Strategies

For more information on FlexShares' approach to infrastructure investing, see our Fund page:

FlexShares STOXX® Global Broad Infrastructure Index Fund (NFRA)

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)

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.

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Past performance is no guarantee of future results. There is no guarantee these investment strategies will be successful. 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.

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