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Stability amid change: Real assets as a portfolio building block

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Real assets are tangible assets such as real estate, infrastructure, commodities, and gold, whose value derives from their use in the real economy. Driven by structural trends such as the expansion of AI infrastructure, electrification, energy and data security, and limited new construction in key real estate segments, they may offer attractive opportunities through 2027. At the same time, they can contribute to diversification and help preserve purchasing power if inflation remains elevated or traditional assets such as equities and bonds weaken at the same time. Careful selection and broad diversification are essential, as factors such as interest rates, regulation, and project-specific risks can also affect the performance of real assets.

We live in turbulent times, and the next few years could bring profound changes. Artificial intelligence, electrification, and energy and data security will increasingly shape how we live, work, and invest. In this environment, real assets are attracting more attention from investors for several reasons. Investments in real assets can make portfolios more resilient, for example during persistent inflation or when equities and bonds come under pressure at the same time.

We define real assets as tangible investments whose value derives from their use in the real economy. Real estate will be familiar to most readers. Other real assets include infrastructure, such as power grids or digital networks, and natural resources, such as energy, metals, and agricultural commodities. Many of these assets generate ongoing income, such as rents or user fees, and are therefore suited to generating regular income. Others, such as commodities, respond directly to scarcity and changes in supply and demand.

Real assets are likely to be supported by structural developments. The expansion of AI is increasing demand for data centers, electricity, and high-capacity networks. At the same time, electrification, energy security, and the reconfiguration

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of supply chains are driving investment in power generation, industrial facilities, and infrastructure. Industrial commodities and infrastructure may benefit. Construction activity has declined in parts of the real estate market, limiting future supply. Against this backdrop, data centers, senior and multifamily housing, and high-quality office space appear attractive to us, as limited new construction may support rents and prices.

Gold plays a special role. Persistent fiscal uncertainty, geopolitical tensions, and inflation concerns can increase demand for the precious metal as a store of value and portfolio hedge. In addition, many central banks are diversifying their foreign exchange reserves to reduce holdings of US dollars. In many cases, significant allocations are shifted into gold. These efforts are likely to continue for years, supporting gold demand. Gold has also often helped stabilize portfolios during periods of falling real interest rates or widening risk premiums.

Commodities and infrastructure investments have a low correlation with a traditional 60/40 portfolio of equities and bonds. Real assets can also help preserve purchasing power if inflation remains elevated. Their return potential varies, however: Infrastructure and real estate offer relatively predictable, partly inflation-linked returns, while commodities and gold respond more strongly to economic and market scenarios. Real assets therefore do not constitute a single defensive asset class. Their performance can vary significantly by sector and market environment. Accordingly, combining these subgroups can provide further value within a portfolio.

Long-term investors may wish to review the role of real assets in their portfolios and gradually increase allocations as needed. One option is a combination of broad commodity indices or exchange-traded funds, gold, and select real estate and infrastructure investments. This combination should align with the investor's risk profile, liquidity needs, and investment horizon. Given project-specific risks, regulatory uncertainty, and potential fluctuations in value, we also recommend broadly diversifying real asset exposures and selecting managers with long, successful track records.

Appendix

Non-traditional asset classes are alternative investments that include hedge funds, private equity, private credit, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. **An investment in an alternative investment fund is speculative and involves significant risks.**

Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

- **Hedge Fund Risk:** There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, "junk bonds," derivatives, distressed securities, non-U.S. securities and illiquid investments.
- **Managed Futures:** There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- **Real Estate:** There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- **Private Equity:** There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- **Private Credit:** There are risks specifically associated with investing in private credit. This could include losses stemming from defaults on loans, which in significant adverse circumstances could result in a substantial loss of investment.
- **Foreign Exchange/Currency Risk:** Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer's "home" currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.

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