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THE GUARDIAN

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Importance of Hard Assets in a Negative-Yield World

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If a friend asked to borrow money, you'd be happy to lend it. And if that friend offered to pay you back with a little extra for your generosity, you'd be grateful. But how would you feel if that friend asked to be paid to borrow money from you?

That is essentially the concept of negative-yielding debt. You pay someone to borrow your money. And it is becoming more commonplace around the world. Even with the distribution of vaccines, new coronavirus cases continue to climb, leading to business shutdowns and restrictions – and increased market anxiety.

Global economic uncertainty has investors so fearful of the future, the world's cache of government bonds that trade at negative rates has ballooned to a new record high. During the fourth quarter of

2020, the global supply of bonds with negative yields hit a new record as the Barclays Global Negative Yielding Debt Index topped $18 trillion.

At the same time, the rise in negative-yielding debt has coincided with a broadly weaker dollar.

Historically, people give the government their money, instead of spending it, with the promise of being paid back, with interest. Now, governments are essentially getting paid to borrow money, as people become increasingly desperate for a safe haven for their wealth. The cycle becomes self-fulfilling as negative rates raise further concerns about the economy.

Central banks often lower interest rates to grow the money supply in the economy, fuel demand and provide growth momentum. As central banks around the world engage in unprecedented monetary easing to counter the economic impact of the pandemic, negative-yielding debt is ballooning, endangering the way the global economy is supposed to function.

However, the growing trend of negative yields has been happening long before coronavirus became a household name. Since the global financial crisis, central banks have cut their targets for short-term interest rates, seeking to make borrowing cheap in hopes that consumers and businesses would boost economic growth by buying cars, taking trips, hiring more workers or investing in equipment.

Another reason for negative yielding debt worldwide could be that institutional investors, like pension funds, are forced to keep buying bonds because of liquidity requirements.

Regardless, this combination of lower returns with higher volatility creates a significant problem for investors. It means they may have to either take on more risk to achieve their same required return or accept a lower return and adjust their goals accordingly.

Achieving the same desired return generally means taking on more equity-style risk. This can make investors vulnerable to large drawdowns, eroding long-term compound returns.

For pre-retirees this increases the impact of sequencing risk, which can lead to big drops in their retirement savings, if drawdowns occur just as they enter retirement phase, causing dramatic changes to their future lifestyle.

In such an investment environment, hard assets are not only attractive, they're necessary.

As a review, hard assets, or real assets, are non-perishable and possess intrinsic value. The three main types are real estate, infrastructure and commodities.

As an investment alternative, hard assets provide security in times of uncertainty, market instability, and volatility. They retain value regardless of how far their market prices may drop. Altogether, they offer a variety of benefits to investors.

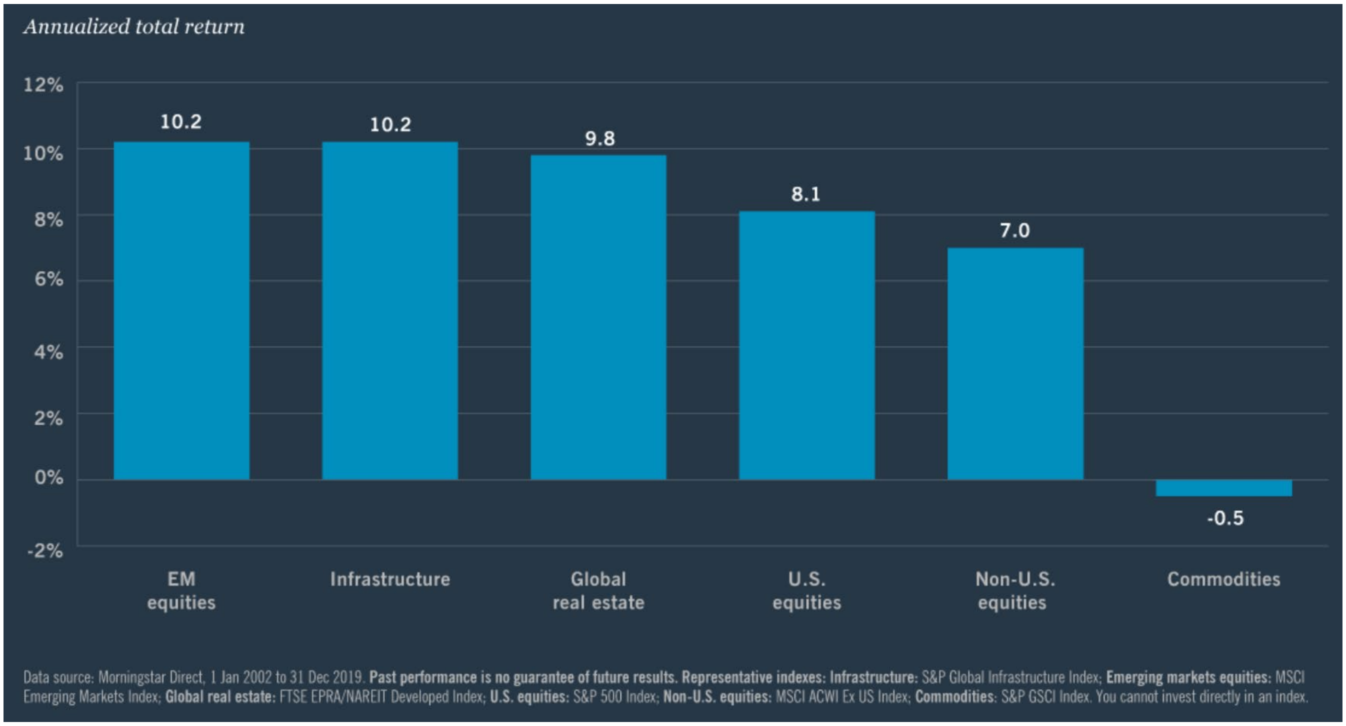
For one, hard assets usually demonstrate a low correlation with conventional investments, such as stocks and bonds. Therefore, their inclusion adds value to a portfolio through diversification.

	Infrastructure	EM equities	Global RE	EM bonds	HY bonds	U.S. equities	Global equities	Global bonds	Municipals	U.S. bonds	Commodities
Infrastructure	**1.00**										
EM equities	**0.82**	1.00									
Global RE	**0.84**	0.75	**1.00**								
EM bonds	**0.68**	0.67	**0.65**	1.00							
HY bonds	**0.71**	0.70	**0.73**	0.75	1.00						
U.S. equities	**0.76**	0.77	**0.75**	0.54	0.68	1.00					
Non-U.S. equities	**0.90**	0.93	**0.81**	0.66	0.73	0.87	1.00				
Global bonds	**0.52**	0.36	**0.45**	0.53	0.29	0.15	0.38	1.00			
Municipals	**0.18**	0.06	**0.23**	0.4	0.26	-0.05	0.04	0.46	1.00		
U.S. bonds	**0.23**	0.07	**0.25**	0.51	0.18	-0.09	0.03	0.72	0.69	1.00	
Commodities	**0.46**	0.48	**0.32**	0.29	0.37	0.35	0.48	0.22	-0.09	-0.07	1.00

Data source: Morningstar Direct, 1 Jan 2002 to 31 Dec 2019. Period shown is the earliest common date amongst indexes; full year S&P Global Infrastructure Index returns start 1 Jan 2002. **Past performance is no guarantee of future results. Representative indexes: Infrastructure:** S&P Global Infrastructure Index; **Emerging market equities:** MSCI Emerging Markets Index; **Global real estate:** FTSE EPRA/NAREIT Developed Index; **Emerging markets bonds:** Bloomberg Barclays Emerging Markets Aggregate Index; **High yield corporate bonds:** Bloomberg Barclays U.S. Corporate High Yield Index; **U.S. equities:** S&P 500 Index; **Global equities:** MSCI ACWI Ex US Index; **Global bonds:** Bloomberg Barclays Global Aggregate Unhedged Bond Index; **Municipal bonds:** Bloomberg Barclays Municipal Bond Index; **U.S. bonds:** Bloomberg Barclays U.S. Aggregate Bond Index. **Commodities:** S&P GSCI Index. You cannot invest directly in an index.

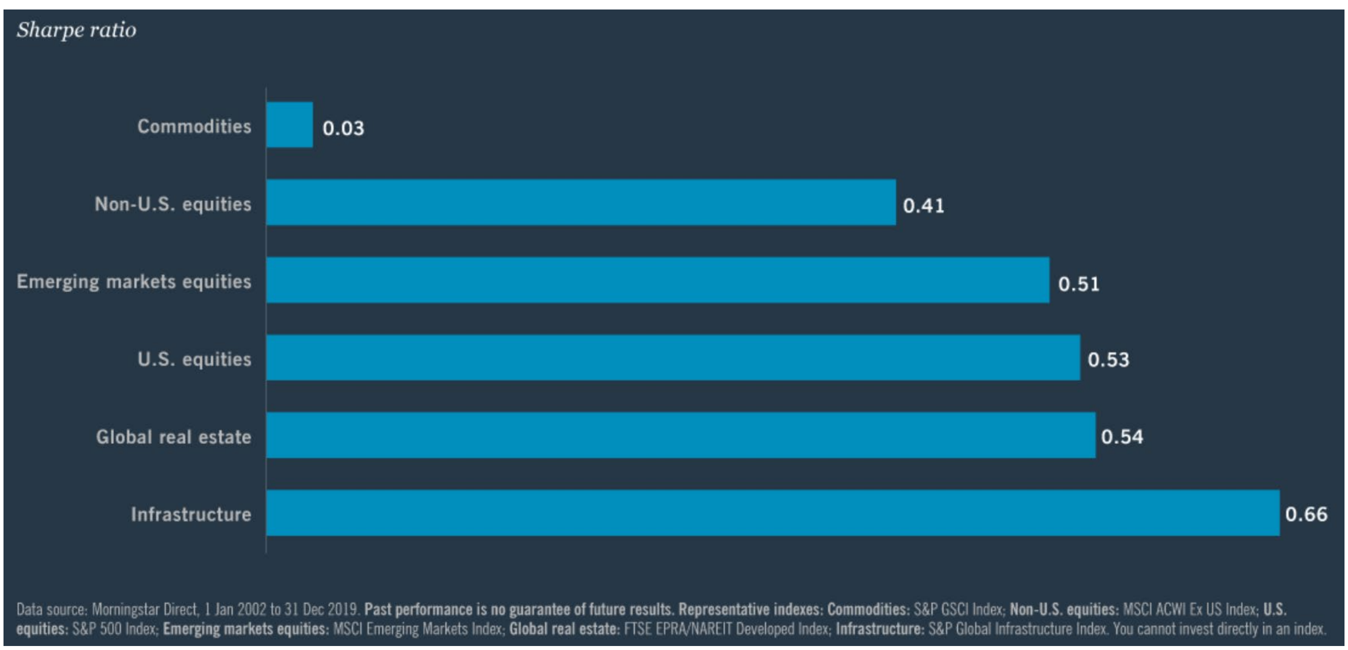
Source: Nuveen Asset Management

Hard assets also offer competitive returns that can outperform most conventional investment assets. Infrastructure and real estate have generated better or similar returns than other U.S. and non-U.S. equities.



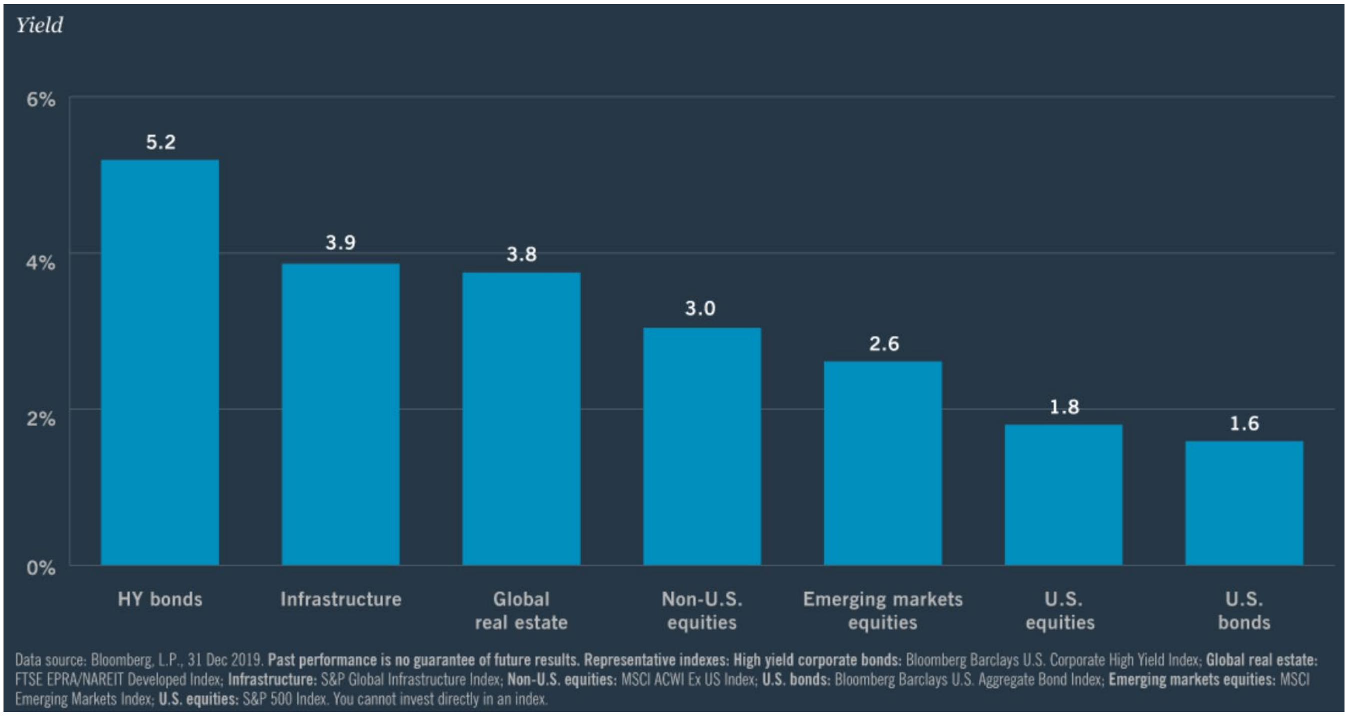
Source: Nuveen Asset Management

Even better, there is a possibility of improving the risk/reward profile of a portfolio by including hard assets in the asset mix. On risk-adjusted basis, as represented by Sharpe ratio, infrastructure and global real estate equities have outperformed both domestic and international equities.



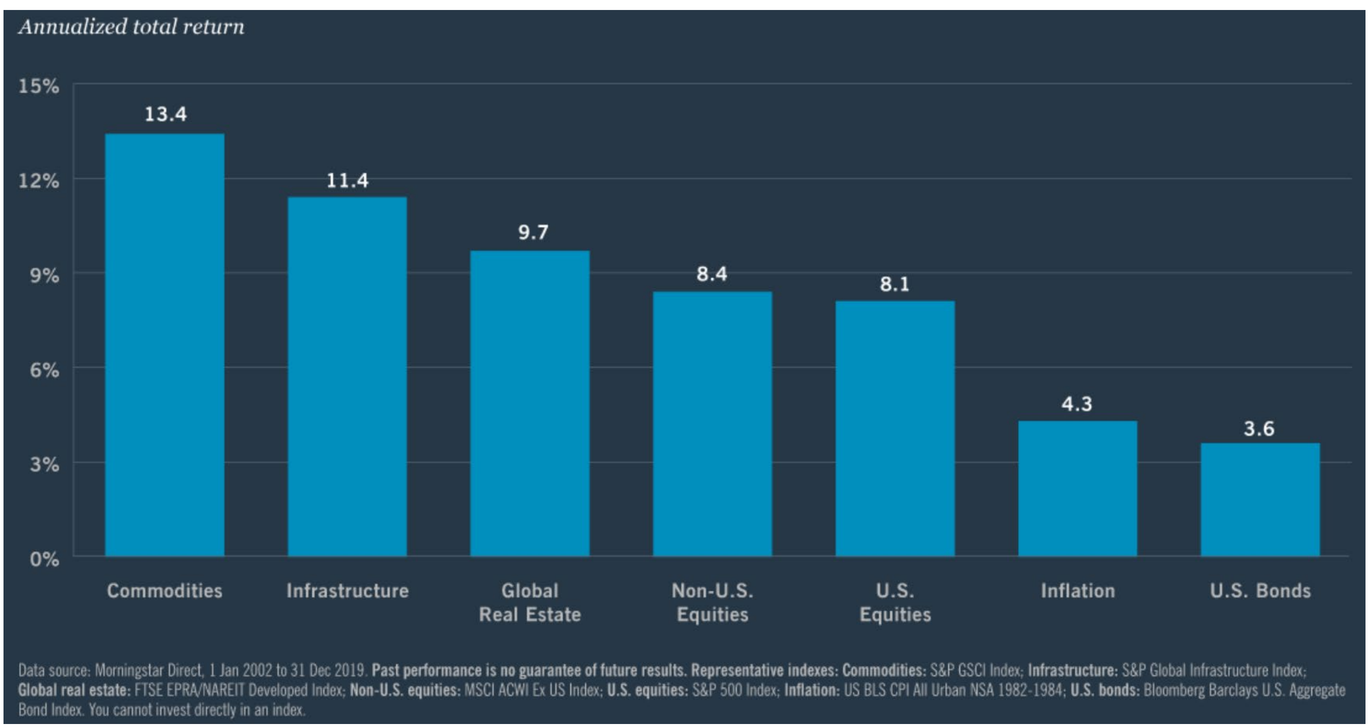
Source: Nuveen Asset Management

Further, infrastructure and real estate are strong and consistent sources for income, derived from their fee-for-use nature. As such, these alternative income sources can prove particularly advantageous for investors in an environment like today where more traditional yield options have turned negative.



Source: Nuveen Asset Management

Lastly, should inflation rear its ugly head, hard assets show a high correlation with inflation, making them perfect hedges. Mainly as their value changes inversely to changes in the value of soft assets and non-physical assets.



Source: Nuveen Asset Management

Ultimately, the value of hard asset investments comes from the physical nature of their underlying assets, allowing them to often store long-term value better than more traditional investments, such as stocks and bonds.

That kind of assurance is invaluable when there are fewer places to turn as an investor. A friend in need is a friend indeed, but why pay for the privilege to lend your money?

LEADING ECONOMIC INDICATORS

	Reference	3rd QTR 2018	2nd QTR 2020	1st QTR 2021	Current	Benchmark	Indication	Reliance & Correlation
1	Economic Cycle Research Institute -U.S. Leading Index	145	132.9	153.5	158.7	NA	↑	95%
2	Organization for Economic Cooperation & Development ("OECD")	99.95	96.00	100.20	N/A	YOY % < 0.7%	↑	95%
3	Chicago Federal National Activity Index ("CFNAI")	0.17	5.33	1.71	N/A	< -0.7	↑	90%
4	Dodge Momentum Index (MHC)	169.8	120.5	151.4	N/A	> 100	↑	90%
5	Starpoint Strategic Investment Indication Model ("SSIM")	-	90			> 100		90%
6	Debt as a percent of Gross Domestic Product ("GDP")	105%	136%	128%	N/A	< 90%	↓ ↓	85%
7	Inverted Yield Curve Ratio	0.86	0.50	1.71	1.58	No Inversion	⇔	80%
8	NFIB US Small Business Optimism Index	107.9	100.6	98.2	N/A	> 95	↑	80%
9	Architecture Billing Index (ABI)	51.1	40.0	55.6	N/A	> 50	↑	75%
10	Institute for Supply Management-Manufacturing Report on Business ("PMI")	59.8%	52.6%	64.7%	60.7%	> 50%	↑	70%
11	University of Michigan Consumer Sentiment Index	100.1%	78.1%	84.9%	88.3%	> 80	↑	70%
12	Crude oil price per barrel	$60.73	$41.71	$59.16	$64.90	< 10% increase	↓	70%
13	Consumer Price Index ("CPI")	252.4	257.8	264.9	N/A	NA	⇔	NA
14	U.S. unemployment rate	4.0%	11.1%	6.1%	6.1%	< 5%	↓	NA
15	Conference Board's Leading Economic Index (LEI)	111.8	102	111.6	N/A	> 100	↑	
16	"Fed" Funds Rate versus Neutral Rate	2.25% vs 2.75%	.08% vs 2.5%	0.07% vs 2.5%	0.25% vs 2.5%		↑	

Notes:

1. ECRI Index is one of the most historically accurate forecasts available.
2. OECD Index is another historically accurate measure. When index has a year over year decrease greater than 0.7% it has signaled a recession 100% of the time.
3. When Index falls below negative -0.70 it has signaled a recession 92% of the time over the last 40 years.
4. A 12-month leading indicator for construction spending for non-residential buildings issued monthly.
5. Starpoint proprietary model for economic forecasts and strategic investment modeling. Figures below 100 signal recession and defensive posture. Above 100 indicate growth and aggressive posture.
6. Reinhart and Rogoff International study on correlation of impact on GDP with sovereign debt levels. Above 90% has strong negative impact on economy.
7. Very reliable indicator of past recessions based on investor yield expectations.
8. The level indicates optimism relative to 1986 (baseline of 100). A positive % change indicates improvement while a negative % change suggests a decline in optimism.
9. ABI reflects survey of architectural firms measuring the percentage of firms reporting significant increase/decrease in activity.
10. Supply side demand index that is an average forecast. Figures above 50% indicate demand and expansion.
11. Consumer Sentiment Index is another average indicator of retail demand. Figures above 80 are positive.
12. Increases in crude oil prices greater than 10% have a broad negative impact on economy.
13. Looking to indexes as indicators of demand and broad fundamentals to imply expansion/growth.
14. General rule that unemployment above 5% is a negative indicator.
15. LEI captures the pulse of the business cycle and has been a strong indicator of economic health.
16. When Fed Funds rate are below neutral, the economy has room to expand. When the Fed Funds rate exceeds neutral, then this restrictive stance will likely slow growth and eventually trigger a recession.

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