

# Liquid real assets in DC pension plans

🔗 We discuss how a strategic exposure to liquid real assets can be a useful component in a DC default investment strategy, providing not only further diversification but also long-term protection in different inflation environments

**R**eal assets are an asset class that covers investment in physical assets such as real estate, commodities, natural resources, precious metals, and infrastructure.

For DC investment strategies, there have been a number of barriers to investing in real assets. Many require large capital investment to be tied up for a long time, which conflicts with platforms requiring daily pricing and dealing. The cost for attaining these exposures along with close-ended fund structures can also be prohibitive. This complexity has dulled investor appetite.

However, liquid real assets are at the more accessible end of the real asset spectrum. The 'liquid' component of liquid real assets indicates that the investment can easily be bought and sold on an exchange through daily liquid mutual funds, index funds, and exchange-traded funds.

## Four main categories of liquid real assets:

Inflation-linked bonds is the most integrated liquid real assets asset class so far in the DC investment design, allowing investors to mitigate inflation risks when purchased for the long term. However, in this article we would like to focus on four additional main liquid real assets categories, as shown below, that could be considered as well:

**1. Real Estate (REITs):** A Real Estate Investment Trust, or REIT, is a fund that owns, operates, or finances income-generating real estate. Investors have the opportunity to earn dividends from real estate, without having to buy, manage, or finance the properties themselves.

**2. Commodities:** The commodity universe includes grains, livestock, oil and natural gas, and precious and industrial metals. Commodity futures within a mutual fund or ETF are used to provide exposure to those assets without the costs of owning physical commodities.

**3. Infrastructure:** This universe includes utilities, transportation, and telecommunication infrastructure. Infrastructure can be accessed through both equity (e.g. shares of listed infrastructure companies) and debt (e.g. infrastructure corporate bonds).

**4. Natural resources:** These assets include exposure to agriculture, oil, energy, and metals. Again, a mutual fund, index fund or exchange-traded fund (ETF) will provide exposure to those assets with greater liquidity.

## How can liquid real assets protect DC pension pots from inflation?

Inflation can eat away at nominal asset returns in DC pension pots over time. It is important to understand how asset classes perform across different inflation regimes. Figure 1 shows the quarterly real asset returns

over the past 20 years for three discrete inflation regimes: rising, stable, and declining.

As seen in Figure 1, real assets provided attractive

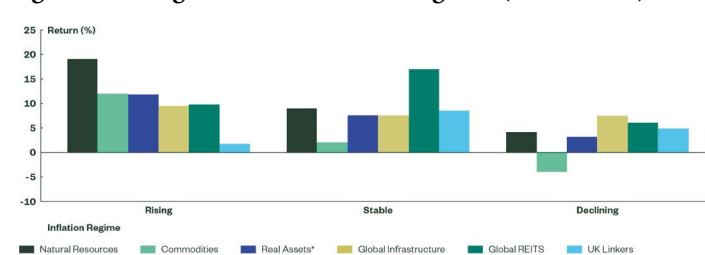
returns not only in rising inflationary regimes, but also during stable regimes. Even in declining regimes, many real assets may generate attractive returns compared to equities, offering an element of downside protection.

- **Real estate investment trusts (REITs)** perform well in stable, and even declining, inflationary environments. Their inflation-hedging ability is embedded in their rental agreement structures, which generally include inflation-linked adjustments or fixed percentage increases in rents.

- **Infrastructure** also performed well in stable and declining inflationary environments. Their revenues for "pureplay" infrastructure are typically stable and predictable given their long-dated underlying contracts and monopolistic assets.

- **Commodities and natural resources** provide efficient protection against unexpected and rising inflation. Commodity futures and natural resource equities have a strong, direct relationship to inflation given the nature of their businesses models (raw materials inputs).

**Figure 1: Average return v/s inflation regimes (2003 – 2024)**



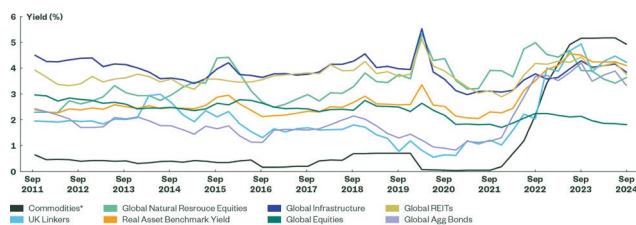
Source: State Street Global Advisors, Bloomberg and FactSet, as at 30 September 2024. All average returns are calculated in GBP.

**Note 1:** Declining regime is an annual decrease in headline CPI of greater than 50bp. Rising regime is an annual increase in headline CPI of greater than 50bp. Stable regime is everything else in between. Historical annual index returns from 2003-2023.

**Note 2:** \*Real Assets Portfolio consists of 20% S&P Global Infrastructure Index, 15% British Government Index-Linked All Stocks, 25% Bloomberg Commodity Total Return Index, 30% S&P Global Natural Resources Index, 10% Dow Jones Global Select Real Estate Securities Index.

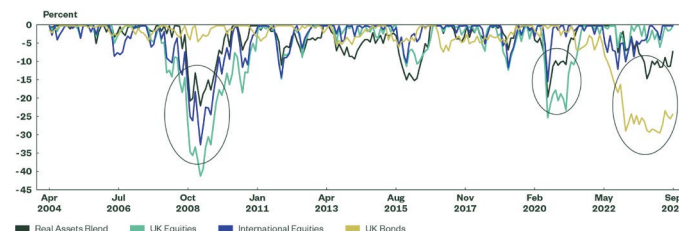
Past performance is not a reliable indicator of future performance. Benchmark returns are unmanaged and do not reflect the deduction of any fees or expenses. Benchmark returns reflect all items of income, gain and loss and the reinvestment of dividends and other income as applicable.

**Figure 2: Historical Yields of Real Assets Components and Benchmark**



\*Proxy with UK Sterling Overnight Interbank Average (SONIA).  
Source: State Street Global Advisors, Investment Solutions Group (ISG) and FactSet. Real Assets Blend consists of 20% S&P Global Infrastructure Index, 15% British Government Index-Linked All Stocks, 25% Bloomberg Commodity Total Return Index, 30% S&P Global Natural Resources Index, 10% Dow Jones Global Select Real Estate Securities Index. As of 09/30/2024.

**Figure 3: Drawdown Analysis: Real Asset Portfolio v/s UK Equities**



Source: State Street Global Advisors, Investment Solutions Group (ISG) and FactSet. Real Assets Blend consists of 20% S&P Global Infrastructure Index, 15% British Government Index-Linked All Stocks, 25% Bloomberg Commodity Total Return Index, 30% S&P Global Natural Resources Index, 10% Dow Jones Global Select Real Estate Securities Index. As of 09/30/2024.

**Liquid real assets’ role in DC plans**

As DC funds grow in size in the UK, their investment strategies continue to evolve from investing in listed equities and bonds. Liquid real assets can provide an effective asset allocation tool in DC pension plans that not only protects against inflation, with a solid income, but also provides diversification benefits and downside protection.

**Liquid real assets key advantages:**

- **Inflation protection:** Real assets have historically provided an

inflation hedge in different inflationary environments, helping investors maintain purchasing power while ensuring adequate retirement income via stable and predictable income streams.

- **Performance:** Allocating to a diversified group of liquid real assets can potentially provide additional returns relative to traditional assets.

- **Downside protection:** Furthermore, liquid real assets have shown effective downside protection versus traditional asset classes, ensuring member pension values have been less impacted during broad market selloffs

(e.g., equity market selloff in '08 and the recent UK bond crisis in '22).

**Diversification:** Liquid real assets have historically demonstrated correlation benefits vis a vis traditional asset classes, as well as with each other.

- **Cost efficient:** Real asset exposure can be obtained individually or managed as a composite strategy. Access through low-cost and liquid vehicles enables DC schemes to meet daily pricing and dealing requirements.

- **DC pensions friendly:** The investment concept is easily understood by members (contractual income from tangible assets and assets indirectly linked to inflation, e.g. commodities), while at the same time reducing complexity of compliance reviews for trustees versus other alternative investments.

**Figure 4: Liquid Real Assets Correlation**

Criteria	Commodities	Global Natural Resources	Global REITs	Infrastructure	UK Linkers	Global Equities	Global Agg Bonds
Commodities	1.00						
Global Natural Resources	0.51	1.00					
Global REITs	0.31	0.48	1.00				
Infrastructure	0.18	0.42	0.58	1.00			
UK Linkers	0.01	0.09	0.35	0.43	1.00		
Global Equities	0.29	0.64	0.72	0.65	0.24	1.00	
Global Agg Bonds	0.18	-0.02	0.31	0.46	0.48	0.23	1.00

Source: State Street Global Advisors. As of 09/30/2024.

Written by State Street Global Advisors retirement investment strategist, **Christos Bakas**, and portfolio specialist, strategist, **Pradeep Channappa**



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