How can we make an allocation to a liquid, daily traded strategy that mimics the performance of private real assets?

**The Client**
A Californian county's $3 billion defined benefit pension plan.

**The Challenge**
Gaining exposure to infrastructure asset class without the complexity associated with private investments.

**Our Approach**
Passive strategies’ low costs and high liquidity make them the best option.

This Californian county’s $3 billion employees’ retirement fund was advised by a consultant with over $1.4 trillion in assets under advisement for a variety of institutional clients, including defined benefit pensions, public funds, and endowments and foundations.

**Tripling the infrastructure exposure through public markets**
The client wished to increase its strategic asset allocation to infrastructure from 2% to 7.5%. Yet doing so would take time and be complex — especially once the search for and hiring of new private strategies was factored in. Even once new managers are selected and hired, the funding of private strategies and return of capital occurs over time through commitment, redemption periods, and capital lock-ups. How then could the client find a public market proxy that would be liquid and immediately contribute similar return and risk characteristics?

The client hired a well-known consultant to help with this challenge and this consultant selected Northern Trust Asset Management (NTAM) in 2019 to create a bespoke, multi-asset solution.

**Opting for a multi-asset, passive solution to replicate private infrastructure**
While the client had been using U.S. REITs as a public market proxy for private infrastructure, they had an unacceptably high level of volatility compared with private infrastructure for this increase in allocation. NTAM pointed it out to the consultant that public infrastructure indices were not perfect either, as they only partially achieve private infrastructure’s qualities of uncorrelated returns, low risk and inflation protection. For this reason, NTAM suggested to add a treasury inflation-protected securities (TIPS) exposure to replicate the inflation protection offered by infrastructure assets such as toll roads or utilities. NTAM created a model and conducted analysis to come up with recommendation to allocate between public infrastructure and TIPS with regular rebalancing whenever the allocation drifted due to market movement from the determined mix.
After discussions between the consultant and NTAM’s multi-asset team, they decided that passive strategies would be more suitable than active due to their lower costs and higher liquidity. In terms of vehicle, the exchange-traded fund and collective investment trust were combined into a single strategy to be an efficient structure.

**A bespoke proxy for private infrastructure**

NTAM developed an infrastructure, TIPS, and cash custom multi-asset solution, with rebalancing whenever the infrastructure or TIPS allocation was above or below its target.

We chose the Flexshares STOXX Global Broad Infrastructure ETF to provide the infrastructure exposure after comparing it with other ETFs. The STOXX index was viewed as the better option because it invests in a broad range of companies deriving at least 50% of their revenues from infrastructure’s five super sectors, as well as government outsourcing and communications. Other competitors primarily or solely invested in energy, utilities, and transportation sectors. What’s more, the STOXX index was less volatile than some of its competitors.

The NT Collective TIPS Index Lending Fund was selected for TIPS exposure due to its low cost, daily liquidity and low tracking error.

While this combination was more expensive than other competitor offerings the consultant was also considering, the consultant believed that NTAM’s offering provided a better proxy for private infrastructure’s return and risk.

**Objectives achieved**

In terms of benefits, the client achieved what it set out to: creating an effective public market proxy for infrastructure, implemented through efficient vehicles. It is now able to incorporate a return and risk profile similar to private infrastructure.

**A success for our client**

The client’s initial investment was $217 million. The consultant liked the solution so much that it is offering this Multi Asset solution consisting of Infrastructure ETF and TIPS in to other clients as a public market proxy or to smaller clients that only invest in public markets due to the complexity and liquidity demands of private market investments.

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Northern Trust Asset Management is a global investment manager that helps investors navigate changing market environments, so they can confidently realize their long-term objectives.

Entrusted with $1.0 trillion in assets,* we understand that investing ultimately serves a greater purpose. We believe investors should be compensated for the risks they take — in all market environments and any investment strategy. That’s why we combine robust capital markets research, expert portfolio construction and comprehensive risk management to craft innovative and efficient solutions that deliver targeted investment outcomes.

As engaged contributors to our communities, we consider it a great privilege to serve our investors and our communities with integrity, respect and transparency.

*OUM as of June 30, 2022. Article published as of June 30, 2022. For more recent AUM, please visit northerntrust.com.
CASE STUDY: CRAFTING A LIQUID REAL ASSETS STRATEGY FOR PRIVATE CAPITAL COMMITMENTS

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