The Birth of Yet Another Darn Asset Class -- Infrastructure (Part 2 of 2)

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The Birth of Yet Another Darn "Asset Class" -- "Infrastructure" (Part 2 of 2)

The article also contains another hallmark of new asset classes: the standard portfolio diversification argument. Buy this asset class and you will reduce your portfolio's risk (and add superior performance to boot). Of course, all the data is backward looking, because that is the only kind of data there is without a time machine.

Incidentally, the financial research record on equities tells us that the most diversified and lowest risk portfolio is the one that contains the broadest of market holdings. Yes, the boring broad market index tends to have the lowest risk while delivering the market return (whatever that will be). This is because virtually every investment security tends to have less than a one to one correlation with all other securities. Therefore, you keep reducing portfolio risk, as you add the remaining universe of available publicly traded securities to you portfolio, i.e. the market portfolio becomes the optimal risk-adjusted portfolio.(Yes, of course, we should mention that the Fama - French multifactor model has demonstrated that a skew toward value and small companies might slightly boost your expected portfolio returns, while lowering your risk. If you are buying the very broad full market and not just a larger company index like the S&P 500, then you are probably picking up the small company effect. That is, if there is any small company effect left to be had in the current markets, since the small company factor was discovered and has been heavily exploited since. The potential from a value tilt probably remains more substantial, but an investor's tradeoff always is the extra investment costs, which are always required to pursue value strategy versus a very low cost, very broad market index investment strategy.) The article makes no mention of what it would cost you to try on this Infrastructure strategy for size. The article does mention that the first global infrastructure EFT that tracks the Macquarie Global Infrastructure 100 Index was introduced in early 2007. Apparently, there was no low cost way to invest in this new asset class during the five to fifteen year back-testing period that provides the data in the article. (So much for an investment time machine, even if you had one.) Incidentally, it also turns out that this new ETF is offered by State Street Global Advisors, the employer of the author this *Journal of Indexes* article.

Since the article calls this EFT, "low-cost access to the space" but does not bother to mention the cost, *The Skilled Investor* looked it up on the SSGA site. The annual Gross Expense Ratio is .6% per year. If your reference point is the outrageous expense ratios of actively managed mutual funds, then this might be considered "low-cost." On the other hand, if your reference point is very low-cost broad market index funds with a .1% annual expense ratio, then the pleasure of taking this active bet on the future of the Infrastructure asset class is going to cost you one-half percent of your assets each and every year. Oh, I almost forgot. You also need to add the transactions costs of buying and selling the ETF amortized over your holding period. Just like every other active strategy, the higher costs compared to a very low cost broad market index investment strategy mean that you have to move your starting blocks some ways back. This strategy better be a performance winner, because you have extra ground to cover, and every year the added costs mean that you have more ground to cover just to break even compared to a lower cost index strategy.So the promise is that this new

Infrastructure asset class will get you higher returns and lower portfolio risk in the future, using backward looking numbers. The article tells you that a 10% allocation to this new Infrastructure category would have added 1.3% annual return to the five year return from the beginning of 2002 to the end of 2006. Not a barnburner, but a handsome increase. How likely is this to be repeated? No one knows. Have Macquarie Bank and State Street Global Advisors discovered a rich new vein of investment gold to mine for years? Will individual investors get any of it? Is this another goldmine for individual investors or is this another selective reading of market history for naive performance chasing individual investors? Is this just a repackaging and expansion of boring old utilities, under a fresh new Infrastructure name? Has this new Infrastructure asset class been riding many of the same asset revaluations of the past few years, which have been offered to justify commodity futures as a supposed new buy-and-hold asset class for individual investors?Is this just more active industry sector rotation in disguise? If so, how long will Infrastructure's hot streak run, before the cycle wanes? A year? Several years? Has the hot streak is already played out? You decide. Me, I'm sticking with the very boring, low cost, broad market, passive index strategy. Costs less. Gets the market return -- whatever that will be. Takes far less time. And, history has shown this passive, low cost index strategy for individual investors to be superior from a risk-adjusted net returns standpoint. Frankly, *The Skilled Investor* thinks that this just another case study of how the securities industry manufactures new products and new broker / investment advisor demand. In turn, these new asset classes are used as bait to capture the assets of individual investors who naively chase historical performance. Only time will tell. I have no investment crystal ball and no investment time machine. Darn it!

Lets tack on something.