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Volatility: friend or foe?

Volatility is part of investing. In the short term, it can cause angst that may lead investors to question their long-term investment strategy. Managed properly, however, volatility can create opportunity to generate strong long-term total returns.

Energy investing: commodity price volatility may create opportunity

In the energy sector, periods of volatility and the dispersion of returns among energy subsectors may create opportunities for skilled active managers to generate strong total returns over the long term. The table below shows how returns among energy subsectors have varied over the last 10 years.

ANNUAL RETURNS FOR ENERGY SUBSECTORS RANKED IN ORDER OF PERFORMANCE

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Crude oil +57.2%	Natural gas -21.4%	Crude oil +77.9%	Midstream equities +35.9%	Midstream equities +13.9%	Natural gas +15.4%	Midstream equities +27.6%	Midstream equities +4.8%	Large-cap energy equities -23.6%	Crude oil +45.0%	Crude oil +12.5%
Energy services equities +38.5%	Energy credit -24.7%	Midstream equities +76.4%	Energy services equities +29.8%	Energy credit +8.5%	Energy credit +11.7%	Upstream equities +27.1%	Natural gas 0.0%	Energy credit -23.6%	Energy credit +38.4%	Natural gas +10.8%
Upstream equities +36.6%	Large-cap energy equities -35.9%	Energy services equities +66.5%	Upstream equities +28.0%	Crude oil +8.2%	Midstream equities +4.8%	Energy services equities +26.2%	Energy credit -7.4%	Crude oil -30.5%	Upstream equities +37.1%	Energy credit +7.6%
Large-cap energy equities +32.4%	Midstream equities -36.9%	Energy credit +51.1%	Large-cap energy equities +17.9%	Large-cap energy equities +2.8%	Upstream equities +3.1%	Natural gas +25.3%	Large-cap energy equities -10.0%	Midstream equities -32.6%	Energy services equities +27.3%	Large-cap energy equities -3.8%
Natural gas +30.2%	Upstream equities -43.1%	Upstream equities +38.8%	Crude oil +15.1%	Upstream equities +0.5%	Large-cap energy equities +2.3%	Large-cap energy equities +22.3%	Upstream equities -30.1%	Upstream equities -36.7%	Large-cap energy equities +23.7%	Midstream equities -6.5%
Midstream equities +12.7%	Crude oil -53.5%	Large-cap energy equities +11.3%	Energy credit +13.0%	Energy services equities -5.5%	Energy services equities 0.0%	Crude oil +7.2%	Energy services equities -35.4%	Energy services equities -37.8%	Midstream equities +18.3%	Upstream equities -10.1%
Energy credit +5.6%	Energy services equities -57.9%	Natural gas +3.6%	Natural gas -27.4%	Natural gas -29.6%	Crude oil -7.1%	Energy credit +6.1%	Crude oil -45.9%	Natural gas -40.8%	Natural gas +9.4%	Energy services equities -22.5%

Data from 1/1/2007–12/29/2017. Past performance does not guarantee future results. This data is for illustrative purposes only. An investment cannot be made directly in an index. Subsectors are represented by the following: Crude oil: West Texas Intermediate spot price; Natural gas: Henry Hub spot price; Large-cap energy equities: S&P 500 Energy Index; Upstream equities: S&P Oil & Gas Exploration & Production Index; Energy services equities: S&P Oil & Gas Equipment & Services Index; Energy credit: ICE BofAML U.S. High Yield Energy Index; Midstream equities: Alerian MLP Index.

Investing in energy and energy infrastructure companies is significantly different than owning a pool of traditional assets, such as stocks and bonds. When investing in energy, investors and their financial advisors should consider an individual's financial objectives, investment time horizon, risk tolerance and liquidity needs.

Continued on back

Tips to take advantage of volatility in the energy sector:

- **Focus on income to enhance total returns.** Energy and energy infrastructure companies may serve as a meaningful source of income as many midstream companies generate predictable and steady cash flow through changing market cycles. Investors may be more inclined to see past short-term market swings if compensated by current income.
- **Seek flexible investment strategies.** Many energy investments access only a narrow segment of the industry, potentially limiting their returns while increasing their level of volatility. Investors should seek out flexible investment strategies that allow the manager to appropriately manage risk and take advantage of investment opportunities caused by market volatility.
- **Identify skilled managers.** As the chart on the previous page illustrates, the difference in annual returns between top and bottom energy subsectors has averaged 44% over the past 10 years. Investing in energy requires investing with a manager that has experience investing across all subsectors and energy asset types (debt and equity) over multiple commodity price cycles.
- **Size your investments appropriately.** Determining the appropriate size of an investment can help ensure that no single investment has an outsized influence on a portfolio's performance.
- **Invest for the long term.** The energy sector offers attractive income and growth opportunities based on strong long-term fundamentals, including rising global energy demand, the need to build and replace U.S. energy infrastructure and the continuous capital needs of energy and energy infrastructure companies to replace their depleting oil and gas resources.

Volatility in any asset class can be challenging for even the most experienced investors. Yet, if managed appropriately, volatility may also create opportunities for returns that can help investors reach their long-term financial goals.

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