

First Sentier Global Listed Infrastructure Fund Monthly review and outlook

Monthly Review and Outlook | December 2022

Market review

Global Listed Infrastructure gave up ground in December as renewed concerns for recession in 2023 weighed on financial markets.

The best performing infrastructure sectors in this risk-off environment were Utilities / Renewables (flat) and Water / Waste (flat). Much of the US was affected by severe winter storms. However, utilities' regulated business models typically treat weather-related costs as a pass-through, meaning that they should be able to recover costs from customers over time. The worst performing infrastructure sector was Energy Midstream (-10%) as investors took profits from the best performing infrastructure sub-sector ytd (and of 2021).

The best performing infrastructure regions were Japan (+1%), where electric utilities were buoyed by government approval of a plan promoting the use of nuclear power; and Asia ex-Japan (+1%), which rose as China lifted its stringent zero-Covid policies. The worst performing infrastructure region was Europe (-6%), as high energy prices and a lacklustre economic outlook weighed on the region's infrastructure stocks.

Fund performance

The Fund returned -1.7% after fees in December¹, 249 basis points ahead of the FTSE Global Core Infrastructure 50/50 TR Index (SGD).

The best performing stock in the portfolio was Chinese water utility Guangdong Investment (+12%), which manages the main concession to provide water to Hong Kong up to 2030. The company's share price continued its recent strong run as investor sentiment towards Chinese stocks was buoyed by the lifting of covid-related restrictions. Chinese-listed toll road operator Jiangsu Expressway (+1%), whose assets include the expressway between Shanghai and Nanjing, also outperformed. However its share price gains were limited as several measures of mobility (less traffic congestion in major cities, reduced subway usage) indicated that rising covid case numbers within China had begun to affect travel and economic activity levels.

US regulated utility holdings performed relatively well as an uncertain economic outlook continued to drive investor demand for stable, defensive assets. Avista (+7%) outperformed following

the favourable conclusion of a rate case for its Washington (state) service territory. Other relatively strong performers in this space included Evergy (+6%), Exelon (4%), FirstEnergy (+2%) and Xcel Energy (+1%), despite a lack of material stock-specific news. A limited sensitivity to the broader economic backdrop, and the numerous capital investment opportunities presented by decarbonization, electrification and resiliency spend, are likely to prove supportive of this sector.

The worst performing stock in the portfolio was US Liquefied Natural Gas (LNG) exporter Cheniere Energy (-14%), despite healthy company fundamentals, as investors took profits following pleasing share price gains earlier in 2022. A favourable outlook for global LNG demand (continued demand from Europe as it seeks alternatives to Russian supply; increased demand from Asia as China reopens) should help to underpin future earnings growth. DT Midstream (-7%), which owns and operates natural gas pipelines, storage and gathering systems in the Northeast and Southern USA; and Pembina Pipeline (-6%), which operates a strategically located portfolio of Natural Gas Liquids-focused energy midstream assets in Western Canada, similarly lagged following robust ytd gains.

Toll roads also underperformed. Brazil's CCR (-8%) fell as financial markets maintained a cautious view of the country's new left wing president Lula, who announced plans to boost government spending in 2023. Australia's Transurban (-7%) and Atlas Arteria (-6%), which are relatively sensitive to interest rate changes, dipped as the US 10-year Treasury yield increased from 3.6% to 3.9% during the month.

Fund activity

The Fund broadened its US utility exposure by initiating positions in Duke Energy and ONE Gas. Large-cap utility Duke Energy provides electricity and gas to over 7 million customers, primarily in North Carolina, South Carolina, Florida and Indiana. The company's assets include a substantial, well-diversified fleet of electricity generation assets and over 400,000km of distribution lines across a service territory covering 270,000 square kilometres. Its rate base is forecast to grow at a compound annual growth rate of 7% up to 2032, driving Earnings Per Share (EPS) growth of between 5% and 7% per annum and supporting a ~4% dividend yield. This stock, which is currently trading at undemanding valuation multiples, was added to the portfolio on the appeal of its stable earnings profile and defensive attributes.

¹ Fund performance is based on the Singapore unit trust, net of fees, expressed in SGD terms. All stock and sector performance data expressed in local currency terms. Source: Bloomberg.

Smaller peer ONE Gas provides natural gas distribution services to over 2 million customers in Kansas, Oklahoma and Texas. The stock has historically traded at a premium to its utility peers owing to its low risk business model and strong management team. However, in November the company unexpectedly downgraded its 2023 EPS and lowered its growth outlook, citing higher interest rates and rising costs. The resulting fall in its share price presented an appealing entry point. We believe that the company is in a strong position relative to peers that may be required to make similar revisions during the course of 2023.

US West Coast freight rail operator Union Pacific was also added to the portfolio. The company owns a 51,700km rail network covering 23 states in the western two-thirds of the United States. Its trains haul industrial, chemical, agricultural, energy, and automotive products, connecting major West Coast ports to the US Gulf Coast, eastern US gateways, the Canadian rail system and Mexico. Recurring service issues, disputes with unions over working conditions and earnings downgrades during 2022 have seen the stock underperform its East Coast peers in recent months. We believe the stock is now positioned to regain ground as service levels improve and the earnings outlook stabilises.

Market outlook and fund positioning

The Fund invests in a range of listed infrastructure assets including toll roads, airports, railroads, utilities and renewables, energy midstream, wireless towers and data centres. These sectors share common characteristics, like barriers to entry and pricing power, which can provide investors with inflation-protected income and strong capital growth over the medium-term.

The asset class remains positioned to benefit from several long term, structural growth drivers. We remain optimistic about the substantial investment opportunities associated with the decarbonisation of the world's energy needs. Utilities, which represent about a half of the global listed infrastructure opportunity

set, are positioned to derive steady, regulated earnings growth by building solar and wind farms, and by upgrading and expanding the networks needed to connect these new power sources to the end user. Technology advances and lower costs for utility-scale battery storage will enable renewables to represent a greater share of the overall electricity generation mix over time. The Inflation Reduction Act, signed into law in August 2022, is expected to provide greater certainty of earnings growth for US utilities, particularly those involved in the transition away from fossil fuels and towards renewables.

Digitalisation is another key long term theme for the asset class. The changes required during the pandemic accelerated a shift towards the use of wireless data in many people's everyday lives. While rising interest rates weighed on Towers and Data Centres earlier in 2022, structural growth in demand for mobile data (underpinned by the growing reliance on digital connectivity) continues to support steady revenue growth for these stocks. 2023 is likely to see the continued rollout of 5G mobile technology. This will require networks to handle increased data speed, and a much higher number of connected devices, to the benefit of towers.

We also see continued evidence of recovery within the transport infrastructure space. Toll roads represent exceptional value at current levels, with traffic volumes (particularly car traffic) proving resilient. These assets are likely to fare relatively well in a higher inflation environment. Many toll roads have concession agreements that specify how prices can be increased, with an option to follow the inflation rate or an agreed percentage – whichever is higher. As a result, year-on-year toll uplifts of between 4% and 7% are likely for many developed market roads. Traffic data from the Airports sector has highlighted a keen appetite to travel, with the strongest traffic recovery seen at tourism-focused airports. We continue to favour leisure airports with a strong network of low cost airlines, such as Spain's AENA or Mexico's ASUR.

Source : Company data, First Sentier Investors, as of 31 December 2022.

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