First Sentier Global Listed Infrastructure Fund
Monthly review and outlook

First Sentier Investors

Market review

Global Listed Infrastructure declined in May on investor concerns that inflation, and therefore interest rates, may remain elevated for longer than previously hoped.

The best performing infrastructure sectors were Railroads (flat) and Other (+1%). Railroads held up thanks to steady returns from Japanese passenger rail, while North American freight rail stocks were supported by attractive valuations and the view that recent volume declines may soon reach a floor. The ports, satellites and merchant power operators that make up the Other sector were buoyed by gains for Emerging Market port stocks.

The worst performing infrastructure sector was Towers / Data Centres (-9%), as concerns for interest rate levels and future leasing demand continued to weigh on tower stocks. During the month both the US Federal Reserve and European Central Bank raised interest rates by 0.25%.

The best performing infrastructure region was Japan (+5%), whose electric Utilities were buoyed by government approval to raise power prices. The worst performing infrastructure region was the United States (-6%), reflecting underperformance from its Tower / DCs, Energy Midstream and Utility / Renewables stocks.

Fund performance

The Fund returned -4.7% after fees in May[1], 118 basis points behind the FTSE Global Core Infrastructure 50/50 TR Index (SGD).

The best performing stock in the portfolio was Italian electric, gas, water and waste utility Hera (+4%), which announced strong March quarter earnings numbers. Areas of note included the company's waste management division, which reported higher waste treatment volumes; and its electricity distribution segment, where higher volumes, new customers and margin improvements drove earnings growth. UK electric utility SSE (+2%) outperformed on better-than-expected annual profits; its gas-fired power stations and gas storage facilities benefitted from the high and volatile energy prices seen over the past year. The company also materially increased its capital investment plans from £12.5 billion up to 2025-26, to £18 billion up to 2026-27, with investment to focus on its networks and renewables divisions. Through plant closures, asset divestments and renewables investment, the company has transformed itself in recent years from a traditional, fossil-fuel heavy, integrated utility to a regulated electricity networks and renewables business.

The portfolio's European and LatAm airport stocks also performed relatively well. Swiss operator Flughafen Zurich (+2%) gained as monthly passenger volumes reached 90% of 2019's pre-pandemic volumes; their highest yet. Although passenger volumes remained robust at Spain's AENA (-1%) and Mexico's ASUR (-2%), both stocks dipped after recent strong gains. During the month, the Europe-focused airline operator EasyJet (-5%, not in our focus list) provided an encouraging trading update, noting that its summer 2023 capacity will be above pre-pandemic levels in most markets.

The worst performing stock in the portfolio was China gas utility ENN Energy (-13%). The stock underperformed as weaker-than-expected purchasing managers' index (PMI) numbers suggested a lacklustre outlook for industrial natural gas demand; while concerns for the health of the Chinese property market weighed on the outlook for domestic gas demand, which is driven in part by gas connections to new properties. The prospect of a slowing property market and economic outlook also weighed on Chinese water utility Guangdong Investment (-11%) and airport operator Beijing Airport (-10%).

US utilities including Dominion Energy (-12%), PPL Corp (-9%) and Duke Energy (-9%) gave up ground during the month, reflecting investor preference for less defensive assets. Uncertainty around asset divestment plans, and a lack of recent price markers, represented an additional headwind for some stocks. Duke has taken longer than expected to divest its renewable energy business, which consists of wind and solar farms primarily in the western US; and Dominion is reportedly seeking to sell several of its natural gas utilities.

The towers sector remained weak, as persistent concerns for softer leasing demand and elevated interest rates outweighed the highly predictable and recession resistant revenue streams offered by American Tower (-10%) and Crown Castle (-8%). Italian peer Inwit (-3%) fared somewhat better on hopes for consolidation within the European towers space. The company announced robust March quarter earnings helped by its inflation-linked contracts, and re-affirmed earnings guidance.

Fund activity

The Fund sold its holding in Australian freight rail operator Aurizon, owing to a lack of faith in the company's new strategic direction. Aurizon is seeking to diversify away from its core businesses of regulated network operation / maintenance and coal haulage, and towards bulk haulage (transporting grain, fertiliser and cotton). Bulk haulage, which is subject to intense competitive pressures, is not an area in which we believe Aurizon possesses a natural advantage.

[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.

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 outlook for the asset class is positive. Balance sheets and dividend payout levels are generally healthy, and appear well placed to weather a deteriorating economic backdrop. We are conscious of potential headwinds in the form of higher interest costs, and elevated regulatory and political risk. Overall however, earnings from this space are expected to be more resilient than those of global equities, owing to the essential service nature of these businesses, and their typically regulated / contracted earnings streams.

Public policy support for infrastructure investment remains strong globally, particularly for the replacement of aged infrastructure assets and the buildout of renewables. Utilities are in the midst of a multi-decade structural growth story. Decarbonisation, electrification and resiliency spend represent large and growing investment opportunities for these companies. These investments drive utilities' rate base growth, leading in turn to earnings growth.

In the communications infrastructure space, structural growth in demand for data continues to support earnings growth in the towers space. Concerns for higher interest rates are now better reflected in valuation multiples. Data centres are positioned to benefit from growing demand for cloud computing, driven in part by the recent surge in AI interest.

Transport infrastructure is benefitting from a recovery in volumes as travellers return to the air; and as the return-to-office trend ramps up. For many toll roads, the high inflation of 2022 will translate into toll uplifts over coming quarters, supporting healthy earnings growth. Traffic data from the Airports sector has highlighted a keen appetite to travel, with the strongest recovery seen at tourism-focused airports.

Source : Company data, First Sentier Investors, as of 31 May 2023.