fundstrategy

Essential play encourages growth

Infrastructure offers diversified and low-risk investment opportunities as urbanisation spreads and governments invest in essential services, such as airports, railways and telecommunications.

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> "The listed infrastructure asset class delivered robust earnings through the worst economic downturn since the Great Depression"

Robust earnings delivered during the global financial crisis reinforced the benefits of a core allocation to infrastructure, but also highlighted the need to consider liquidity as part of an overall investment strategy. For investors who can look past short-term volatility, global listed infrastructure funds offer the long-term benefits of the asset class with the convenience of daily liquidity.

Infrastructure describes the physical assets that provide essential services to society. These assets tend to have high barriers to entry, strong pricing power, predictable cash flow, and structural growth opportunities that are sustainable through economic cycles. Key infrastructure assets include toll roads, airports, ports, railways, utilities, oil and gas pipelines, satellites and mobile phone towers.

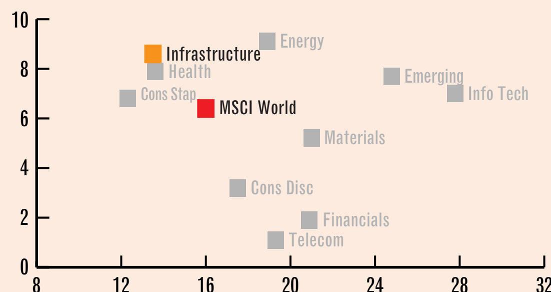
The global infrastructure market has developed significantly over the past 20 years, with the substantial increase in private sector ownership providing a diversified investment universe – across assets, sectors and countries. A strong growth outlook for the market reflects structural drivers, including catch-up investment following decades of government under-investment, globalisation, urbanisation, economic development in emerging economies, and diversion of government funds to health and welfare.

Demand for the infrastructure asset class continues to mature and is no longer the domain of large pension funds. A range of investors are making separate allocations in their long-term investment strategies. Investors with a preference for liquidity are accessing these assets via a diversified portfolio of listed companies from around the globe.

Earnings of listed infrastructure companies tend to be protected against inflation owing to regulated returns, inflation-linked pricing, contracted price escalators, or monopolistic industry structures that allow price rises without destroying demand.

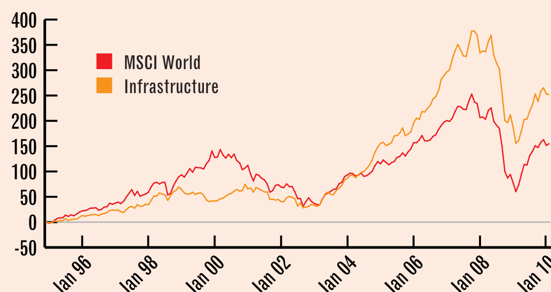
In addition, most listed infrastructure companies enjoy structural growth opportunities, which continue to drive sector earnings faster than the global economy. These include above system growth from global trade volumes in airports, ports and railways; urban congestion funnelling cars and trucks from congested free roads to tolled roads; changing supply and demand dynamics, combined with energy security needs driving new expenditures in oil and gas pipelines and storage; and advances in wireless telephony and digital television expanding the network of mobile towers and satellites.

RELATIVE RISK AND RETURN OF GLOBAL INFRASTRUCTURE



Shows risk (standard deviation of returns – horizontal scale) and return (total return per year – vertical scale) in dollar terms for various sectors, in percent, from January 1994 to February 2010. Source: Bloomberg

PERFORMANCE OF GLOBAL INFRASTRUCTURE



Shows total percentage return of the MSCI World and UBS Global Infrastructure & Utilities 50-50 indices, in dollar terms, from December 1994 to February 2010. Source: Bloomberg

Last, the low risk and long duration of infrastructure assets makes them attractive to pension funds, sovereign wealth funds, unlisted funds and other long-term investors. These investors have been acquiring listed infrastructure companies over the past decade with an acceleration as debt markets re-opened last year. Recent examples include Warren Buffett's acquisition of Burlington North Santa Fe, an American railway, and the acquisition by JP Morgan Asset Management of Los Angeles-based SouthWest Water Company for a 71% premium. If listed markets do not price these assets closer to their intrinsic value, long-term investors will – to the benefit of global listed infrastructure fund investors.

For the 15 years ending December 2009, global listed infrastructure delivered higher returns than global equities (8.6% versus 6.4% per year) for lower levels of risk (13.5% versus 16.0%), according to the UBS Global Infrastructure & Utilities 50-50 and MSCI World indices. The correlation of returns was 0.67. This performance highlights not only the defensive nature of the asset class but also the structural growth within these assets.

In the midst of the global downturn, from 2007 to 2009, operating profits – defined as earnings before interest, tax, depreciation and amortisation – from the global listed infrastructure sector increased by about 4%. This compares favourably with a 25% decline in operating profits for American equities, or a 3% contraction in developed world GDP over the same period. In addition, dividends per share paid to shareholders of global listed infrastructure companies increased by about 6%.

These results show that the listed infrastructure asset class delivered robust earnings through the worst economic downturn since the Great Depression. How was this possible? Infrastructure earnings are driven by the essential nature of the products (water, gas, electricity or commuter traffic, for example), regulated returns on new capital expenditures, capacity additions underpinned by new contracts, and the ability to increase prices without destroying demand. These factors, combined with the structural growth in many of these assets, underpin a robust earnings story for infrastructure.

The global listed infrastructure asset class stood up and delivered for investors. These low-risk assets provide structural growth, an inflation-protected income stream, and portfolio diversification benefits from relatively low correlation with other asset classes.