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OUTLOOK

2023 Investment Outlook: Global Listed Infrastructure

January 20, 2023

Listed Infrastructure has Potential for Resilient Earnings and Strong Cash Flow

KEY POINTS

1. Most infrastructure companies have some form of inflation protection embedded into their contract structure.
2. An interest rate tailwind for valuations is likely if long-term interest rates peak and moderate.
3. We have started to move toward a more defensively positioned portfolio, lowering exposures to energy and certain aspects of transportation (for example, freight), while increasing investments in utilities and communications.

What We Are Seeing

In 2023, consistent with consensus, we believe there is a high likelihood of some form of economic downturn, as well as a deterioration of earnings and cash flow for the broader equity markets. Nonetheless, we expect resilient earnings, strong cash flow and largely unimpacted capital programs for listed infrastructure in 2023. A large swath of our investment universe is set up for a favorable, positive earnings trajectory in 2023, and if inflation stays sticky, most infrastructure companies should still hold up well, as companies have some form of inflation protection embedded into their contract structures.

Utilities remain a very stable sector within infrastructure because of embedded demand: people need water, electricity and natural gas to live their lives. Moreover, the proliferation of clean energy investments is being accelerated by the Inflation Reduction Act in the U.S. and renewable energy directives in Europe, which are a boost to existing capital programs. The focus on energy transition, energy security and existing asset replacement ensures solid, long-term secular growth for the utility sector.

Communications was among the worst performers of 2022, so we see potential from a mean reversion perspective. Earnings visibility and cash flow visibility are excellent in the communications sector, where we are predominantly invested in wireless tower companies. Tower companies rely on long-term leases, whereby every time a carrier adds equipment, additional "rent" is secured. The sector is benefiting from an interconnected digital world, increasing data usage and the buildout of 5G wireless technology.

The transportation sector (including toll roads, airports, seaports and passenger and freight railroads) is more economically exposed, especially for freight-related movements. Coming out of the pandemic, there has been some recovery of traffic and freight volumes as demand has recovered, although the magnitude has varied by geographic location and type of product/person transported. While post-pandemic recovery was generally a tailwind in 2022, we anticipate a moderation in the growth rate for 2023, outside of the airport sector, where demand for leisure travel remains strong. Despite this second-derivative decline in the growth rate, we view absolute volume declines as unlikely for most transport modes, and we believe the sector is set up for potentially positive performance in 2023, as valuations are undemanding.

What We Are Doing

We invest in four broad groups: utilities, energy infrastructure, communications and transportation, and the setup for 2023 is broadly favorable. Utilities and communications are generally perceived to be very defensive asset classes, with very strong earnings visibility and low likelihood of material earnings revisions, in contrast to the broader equity markets. Indeed, relative to other equity sectors, utilities generally have the lowest variability of earnings.

We are being more cautious on the more economically exposed areas of the asset class, such as energy and transportation, because of the strong recovery coming out of the pandemic and particularly favorable 2022 performance for energy infrastructure. Despite this view, we still believe there is potential for favorable positive performance in 2023. We are likely to see a moderation in the rate of earnings and cash flow growth for transportation companies, but it is unlikely they will decline in an absolute sense. Airports continue to be busy and may receive an additional boost to growth with the re-opening of China.

Consistent with the statements above, we have started to move toward a more defensively positioned portfolio, with some lower exposures to energy and certain aspects of transportation, and we may continue that trend into 2023.

What We Are Watching

Putin's invasion of Ukraine has changed the dynamics of traditional fossil fuel-based energy, while accelerating the need for renewable energy deployment. Before the war, there was far less investor interest in traditional fossil fuel-based energy investments, both midstream

and upstream; but with investor focus shifting to energy security, demand for traditional energy exposure has recovered. At the same time, interest in clean energy investments remains strong, with opportunities across wind, solar, carbon-capture and sequestration technologies, and hydrogen.

As congestion and supply chain woes ease, margin pressure should start to abate. This is particularly helpful in areas like freight rail, which was negatively impacted in 2022.

On the more cautionary side, we continue to closely monitor the impact of recent energy price trends on customer utility bills. While utilities should, in theory, be protected from political interference through their regulatory compacts, high customer bills are commonly a talking point for politicians, especially during periods of economic hardship, such as a recession.

An interest rate tailwind for valuations is likely if long-term interest rates peak and moderate.

The gap between listed and private-market infrastructure valuations remains large, presenting an opportunity in the listed markets due to the amount of private capital raised yet to be deployed. Private-market takeout opportunities should help to provide a floor for listed infrastructure companies, even in a recessionary environment.

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Real Assets

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