OUTLOOK

2024 Outlook: Global Listed Real Assets

By: Laurel Durkay | & Matthew King | December 14, 2023

Powerful Secular Themes Drive Demand in Listed Real Assets

KEY POINTS
1. The expected stabilization in interest rates globally is expected to benefit listed real assets.
2. Under current credit conditions, our analysis focuses on balance sheets to ensure strategies are best protected.
3. We expect continued divergence in performance among sectors into 2024.

What We Are Seeing

Today's real estate investment trust (REIT) market is continuously evolving to meet the needs of the public and may benefit from the necessity-based nature of traditional properties like shopping centers, industrial facilities, and apartments, as well as specialty properties, such as cell towers, data centers and health care clinics. Historically, the properties owned and operated by REITs have provided more insulation to earnings than have more discretionary investments.

Infrastructure sectors such as utilities, airports, roads, ports, oil and gas pipelines, and wireless telecommunications towers provide the network for global commerce. The need to deploy capital to repair and expand existing infrastructure, as well attractive returns remain key elements of the asset class.

Energy transition and innovation opportunities (ETIO) companies focus on providing solutions to climate change through mitigation and adaptation. These ETIO companies are involved in areas like renewable power development, electric transmission and distribution utilities, solar power equipment, energy efficiency, electric vehicles, battery storage, lithium, and waste management. Enacted in 2022, the Inflation Reduction Act (IRA) may be transformative for the U.S. cleantech sector, as it provided strong incentives for a range of Climate Transition companies.

Beyond the longer-term benefits of these asset classes, we're focused on the tactical opportunity following recent underperformance. Resultant valuations for REITs and GLI (global listed infrastructure) are attractive, screening cheap versus broader equities, private real assets, their own historical averages, and generally in-line with average spreads versus fixed income. Additionally, there are many climate-mitigation companies that are trading below pre-IRA levels despite potentially significant benefits.

What We Are Doing

Given current credit conditions, our analysis focuses on balance sheets to ensure strategies are best protected.

We favor REIT sectors with longer term and secularly supported characteristics underpinning demand, such as data centers (bolstered by technology and innovation), seniors housing (aging demographics), single family rental housing and multi-family apartments (housing shortages and affordability), and logistics (global supply chain reorganization and onshoring). In addition, we believe companies with reasonable costs of capital and strong balance sheets, as well as low leverage and limited debt maturities, may potentially reactivate external growth in a meaningful way and provide upside earnings surprises.

For GLI, we currently view the valuation skew as attractive across all sectors except airports, which are marginally less attractive due to strong 2023 performance. For the more defensive areas of utilities and communications, we see steep discounts to historical relative valuation ranges and, in the case of utilities, a solid fundamental backdrop. While our sector weightings are not significantly outside benchmark levels, we have material company-specific "bets."

For ETIO, we favor companies with relatively strong competitive moats, strong balance sheets, less cyclical (more secular) growth, and reasonable valuations.

What We Are Watching

With the Federal Reserve holding interest rates steady for two consecutive meetings and an encouraging U.S. Consumer Price Index (CPI) reading in November 2023, there have been increasing signs that stubbornly high prices are easing their grip on the U.S. economy and the Fed may be done hiking rates. The expected stabilization in interest rates globally is expected to benefit listed real assets. We anticipate a recovery in credit and lending markets, which may increase merger and acquisition (M&A) activity, crystalizing value and potentially producing favorable returns.

Sectoral composition and differentiation are vital when analyzing the underlying risk/reward profile and performance of listed real assets and climate change companies and help to create opportunities for active managers. We expect continued divergence in performance among sectors, as secular themes driving demand are powerful and can propel growth above expectations in exposed sectors for years—and ultimately reset warranted valuations higher.

Past performance should not be construed as a guarantee of future performance. *Returns provided in USD terms. There is no guarantee that any historical trend illustrated above will be repeated in the future, and there is no way to predict precisely when such a trend might begin. It is not possible to invest in an index. Provided for illustrative purposes only.*

Risk Considerations: *The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the U.S. and global markets. The value of equity securities is sensitive to stock market volatility. Changes in real estate values or economic downturns can have a significant negative effect on issuers in the real estate industry including REITs. Diversification does not eliminate the risk of loss. Active management attempts to outperform a passive benchmark through proactive security selection and assumes considerable risk should managers incorrectly anticipate changing conditions.*

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