First State Investments
首域投資

Global Listed Infrastructure

Monthly Review and Outlook

As at December 2015

- First State Global Listed Infrastructure Fund invests in global listed infrastructure and infrastructure-related securities.
- Investing in shares in a single sector may expose the Fund to greater volatility than investing in multiple sectors. The value of the Fund may be impacted by risks associated with listed infrastructure including changes in environmental regulations. It is possible that the entire value of your investment could be lost.
- All or part of the Fund’s fees and expenses may be paid out of capital resulting in an increase in distributable income and effectively a distribution out of capital. Similarly in certain circumstances dividends may be paid out of capital. This amounts to a partial return of an investor’s original investment, or from any capital gains attributable to that original investment, and may result in an immediate decrease of the Net Asset Value per share.
- You should not base your investment decision solely on this document. You should not invest unless the intermediary who sells it to you has advised you that the Fund is suitable for you and explained how it is consistent with your investment objectives.



Welcome to the latest monthly update on First State Global Listed Infrastructure Fund, providing a review of the Fund and latest outlook for the sector.

Key highlights:

- The Fund declined -1.1% in December, outperforming the benchmark and holding up relative to global equities -1.7%
- Demand for defensive assets and predictable earnings supported utilities and toll roads.
- Lower commodity prices continued to weigh on pipelines and railroads.
- The Fund invests in a wide range of global listed infrastructure assets which can provide investors with inflation-protected income and strong capital growth over the medium term.

Market review

Global listed infrastructure held up relatively well in December against a backdrop of volatile financial markets and the Federal Reserve’s first interest rate increase in nine years. In USD terms (total return), the FTSE Global Core Infrastructure 50-50 Index dipped 1.2% during the month, compared to a 1.7% fall by global equities.

Utilities gained following the well-flagged US rate rise, and on the expectation that future increases would follow a gradual, data dependent trajectory.

Pipelines was the worst performing sector as collapsing energy prices heightened concerns about the viability of the Master Limited Partnership structure, widely used by energy pipeline operators, which requires continuous access to capital markets. The ousting of Cheniere Energy’s CEO by the Board was the latest reflection of turmoil within the sector. **Railroads** underperformed as investors focussed on North American Class I railroads’ persistently soft volumes; and as Norfolk Southern’s aggressive rejection of Canadian Pacific’s repeated takeover approaches clouded near-term hopes of industry consolidation.

The best performing region was **Asia ex-Japan**, as toll roads and airport operators led the region higher. Demand for defensive electric and gas utilities saw the **UK** gain.

North America fell due to pipeline and railroad declines. The underwhelming scope of the ECB's latest QE announcement weighed on infrastructure stocks in **Europe ex-UK**.

Fund review

In USD terms, the Fund dipped 1.1% in December[1], 10 bps ahead of its benchmark index.

The best performing stock in the portfolio was **Magellan Midstream Partners**, which operates the longest refined product pipeline network in the US; as well as an expanding network of crude oil pipelines; and marine terminal facilities. Having been caught up in the wider pipeline sector sell-off earlier in the year, the stock rebounded on investor recognition of its relatively stable business model, conservative management team and well capitalised, investment-grade balance sheet. **TransCanada** and **Columbia Pipeline Group** also regained ground.

Utilities took the US Federal Reserve's 0.25% interest rate rise in their stride. Gains for large cap US utilities **Duke Energy**; **NextEra Energy** and **PG&E** highlighted investor demand for predictable, regulated earnings streams. Smaller operator **ITC Holdings** continued its "review of strategic alternatives", fuelling speculation that it may be acquired. **Alliant Energy** climbed after reaching an agreement with WEC Energy relating to the proposed construction of a Wisconsin natural gas-fuelled power plant. Hong Kong based **Power Assets Holdings** rose as investors bought into the global collection of utility assets controlled by Li Ka-Shing, owner of Cheung Kong Infrastructure and one of the world's richest men.

Airports continued their strong run. **BBA Aviation**, which operates airports for US business jets, gained as US business jet volumes bounced back after recent weakness. German peer **Fraport** rallied after its consortium signed a €1.2 billion contract to manage 14 Greek airports. Mexican operator **GAP** gained as double digit passenger growth at its airports, driven by new routes and keen domestic and international demand, complemented improving retail facilities. Spanish airport **AENA** lagged peers in December on regulatory uncertainty after inconclusive Spanish election results delayed the formation of a new government.

The portfolio's toll road holdings delivered mixed returns. Chinese operator **Jiangsu Expressway** increased on consistently robust traffic volumes and the appeal of its high margin, high barrier-to-entry business model. Australian peer **Transurban** was buoyed by the news that it had negotiated an agreement to develop the Western Distributor toll road in Melbourne. Following its acquisition in November of Brisbane's Airportlink toll road, the move further underpins Transurban's dominant position in Australia's three largest cities. European peers **Vinci**, **Atlantia** and **Abertis** were impacted by disappointment that the ECB's latest QE measures delivered less stimulus than had been expected.

The worst performing stock in the portfolio was an underweight position in US pipeline company **Kinder Morgan**, which slid ahead of a 75% dividend cut announced in early December – especially significant in a sector where dividend growth has been promoted as a key driver of value. The substantial cut will reduce Kinder Morgan's reliance on external capital markets and enable the company to strengthen its balance sheet while using internal cash flows to fund its growth project pipeline. Spectra Energy was also impacted by negative sentiment towards the sector, though we note the company reconfirmed its cashflow and dividend outlook in early January.

The other main detractor from Fund performance was US railroads, which faced persistent volume weakness, notably in the coal, intermodal and agricultural segments. **Kansas City Southern** and **CSX** announced earnings downgrades, while **Union Pacific** cautioned that volumes face continued headwinds. The impact of lower volumes is being mitigated by core price increases, and by ongoing operational improvements; which over the medium term have been the most significant drivers of earnings growth for the sector.

Transactions

During the month the Fund initiated a position in **Xcel Energy**, a US$18 billion market cap US utility serving approximately 3.5 million electricity customers and 2 million gas customers across a service area spanning eight Midwestern and Western states. The company plans to spend US$15bn through to 2020, building renewable energy projects and replacing an aging generation fleet and electric transmission infrastructure. This will give the company a transparent runway of earnings and dividend growth potential; management are forecasting EPS growth of 4 – 6% and DPS growth of 5 – 7% during this period.

Long-term holdings in US utilities Atmos Energy and PPL Corp were sold after material share price gains during their respective holding periods reduced mispricing.

Outlook

The Fund invests in a wide range of global listed infrastructure assets including toll roads, airports, ports, railroads, utilities, pipelines, mobile towers and satellites. 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.

A combination of factors has weighed on listed infrastructure in recent months. The prospect of rising US interest rates has dragged on utilities; volume softness has overshadowed US railroads; and collapsing energy prices have hurt pipelines. The Fund has been reasonably well positioned in this environment, with underweight exposure to utilities; and a focus on gas over crude oil pipeline operators. Although our positioning has enabled us to create alpha, recent returns from the asset class in absolute terms have not matched our long-term expectations.

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[1] The Fund's calendar year performance: -5.7% (2015); 12.3% (2014); 17.3% (2013); 10.4% (2012); 1.2% (2011).

These headwinds now look set to reverse. The uncertainty ahead of the Federal Reserve's first rate rise has now been removed. US railroad earnings downgrades announced in 2015 will make it easier to achieve 2016 earnings growth. Rail companies are trading at cheap valuations, have low debt levels, and are cutting costs and buying back shares. Whilst further earnings and capital expenditure downgrades are expected across the pipeline sector, share price declines have presented active managers with opportunities to buy high quality infrastructure assets at very appealing valuations.

Financial markets remain volatile and it is unclear what the next few months may bring. However we are confident that on a 12-month view fundamentals will assert themselves and that listed infrastructure's characteristics of high barriers to entry, pricing power, predictable cash flows and sustainable growth will help to drive pleasing outcomes for investors.