First State Investments
首域投資

Global Listed Infrastructure

Monthly Review and Outlook

July 2016

- 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.

Key highlights:

- In USD terms (total return), The First State Global Listed Infrastructure Fund built on gains from previous months, rising by 2.4% in July and outperforming its benchmark index by 0.33%.
- Growth infrastructure rallied led by Ports and Railroads, while Utilities were flat.
- With valuations full from a historical perspective, active management will be increasingly important.

Market review

Global listed infrastructure generated strong absolute returns in July on the back of positive quarterly earnings numbers and an uplift in confidence across financial markets. In USD terms (total return), the FTSE Global Core Infrastructure 50-50 index rose 2.1% during the month, while global equities increased 4.3%.

The best performing infrastructure sectors were **Ports**, **Railroads**, **Airports** and **Toll Roads** . These sectors benefit from rising volumes associated with increased levels of economic activity. Chinese-listed ports and US freight railroads were amongst the biggest gainers, on the view that valuation multiples had reached overly bearish levels.

Utilities (flat) paused as investor focus switched to growth, following substantial returns from this defensive segment of the market during the first half of 2016.

The best performing region was **Oceania** which was supported by a relatively positive economic outlook; greater political certainty; and the potential for reduced interest rates in Australia. **Asia ex-Japan** performed well as China's stabilising Q2 growth rate offered support to the region's toll roads and ports. The UK was held back by its high weighting to utilities.

Fund review

In USD terms, the Fund rose 2.4% in July[1], outperforming its benchmark by 0.33%.

The best performing stock in the portfolio was **Japan Airport Terminal**, which surged on news that local communities had approved a landing slot increase at Tokyo's Haneda Airport, making government approval highly likely by the end of the year. The capacity boost ahead of Tokyo's 2020 Olympic Games will enable Haneda to serve more international passengers.

Spanish airport operator **AENA** was buoyed by consistent passenger and revenue growth as Spain continued to be seen as a relatively safe and attractive tourist destination. **BBA Aviation**, which operates private jet airports in the US, outperformed as investors grasped the potential for revenue synergies and cost reductions following last year's takeover of the Landmark flight support business. However, Mexican peer **GAP** dipped despite announcing Q2 results that included a 15% increase in passenger volumes and raising 2016 earnings guidance.

The Fund's US freight rail holdings delivered robust returns as second quarter results highlighted the resilience of these well-run businesses in a soft volume environment. **CSX** and **Kansas City Southern** achieved better than expected Q2 earnings through disciplined cost control and consistently firm pricing. **Union Pacific**, the largest Class I railroad, mitigated the impact of lower volumes through core pricing growth and operational efficiency improvements. Signs that volumes may be bottoming are beginning to emerge. Strong operational performance across the sector bodes well for earnings growth, once volume comparisons become easier in the quarters ahead.

Toll roads climbed, led by Brazil's **CCR** ; Spain's **Abertis** and Australia's **Transurban**. These high quality, low risk companies gained as their ability to generate robust free cash flows, supporting generous dividend yields, continued to draw investor interest.

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

Port operators **China Merchants Ports** and **COSCO Pacific** outperformed on investor recognition of the value on offer in the sector. Forecasts that container volumes between Asia and Europe would grow by 3.9% in 2016 provided further support. This represents a marked improvement over that route's 3.2% contraction in 2015, and would have a positive impact on ship utilization levels and freight rates. Japanese peer **Kamigumi** lagged due to its relatively defensive business profile, underpinned by a cash-rich balance sheet.

In the pipelines sector, a lower oil price weighed on **Enbridge Inc** and **Spectra Energy**. More positively, **Kinder Morgan** rallied after strengthening its balance sheet by selling a 50% stake in one of its natural gas pipeline systems to US utility **Southern Co (flat, not held)** for US$1.47 billion. The transaction underpins the value that can be attributed to Kinder Morgan's long-life pipeline assets.

The worst performing stock in the portfolio this month was US-focused tower company **Crown Castle** which lagged after outperforming in H1. Peers **SBA Communications** and **American Tower**, which both generate a proportion of their earnings from faster-growing markets such as India and Latin America, delivered positive returns. Structural growth in demand for mobile data continues to underpin earnings growth across the sector.

The other main detractor from Fund performance was the utilities sector. Following a considerable rise in recent months, US and UK utilities including **Eversource Energy**, **Xcel Energy**, **NextEra Energy**, **National Grid** and Duke Energy lagged as US 10 Year Treasury yields ticked up.

This month, the Fund trimmed its exposure to the energy pipeline sector by exiting its position in US energy pipeline operator Magellan **Midstream Partners**. Gains during the Fund's holding period saw the stock move lower within our investment process. The company has a high quality asset base and a stable earnings profile; however we believe these characteristics are reflected in its current share price.

Outlook

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

Keen demand for defensive assets has caused listed infrastructure to trade up to valuation multiples which are full from a historical perspective. However, when considered in the context of low bond yields, there is value relative to other asset classes. Mispricing and value opportunities can be also identified both between and within sectors, making active management increasingly important. For example, our investment process currently favours toll roads, railroads and mobile towers. We believe the market continues to underestimate the volume recovery potential and strength of pricing power available to these sectors.

We would also note that leverage and payout ratios are lower than normal for most sectors, providing opportunities for well managed companies to deliver shareholder returns which surprise on the upside. Therefore, while unlikely in the near term to match the 10%-15% pa returns seen in the past, we expect listed infrastructure to continue to offer reasonable risk-adjusted returns to investors.