First State Investments

# Global Listed Infrastructure

## Monthly Review and Outlook

March 2016

## Key highlights:

- Global listed infrastructure continued to climb in March as confidence returned to financial markets
- The Fund gained +3.1%, the benchmark index +3.5% and global equities +2.3%
- Every sector and region generated positive returns, led by Ports and Latin America

## Market review

Global listed infrastructure climbed strongly in March as supportive central bank commentary sparked market optimism and drove investor appetite for income-generative assets. In SGD terms (total return), the FTSE Global Core Infrastructure 50-50 index rose 3.5%, while global equities ended the month 2.3% higher.

The best performing sector was Ports as Asian operators rallied on the view that stabilising Chinese growth and improving global economic activity levels would support volume growth. Utilities were buoyed by the cautious tone of US Federal Reserve Chairwoman Janet Yellen, who referred to a careful, patient approach to rate rises.

Railroads lagged rising markets. North American freight rail operators continued their share price recovery, helped by a less pessimistic outlook for the US economy. CSX Corp was reported to have rejected a takeover approach from Canadian Pacific (not held) in January, highlighting CP's determination to bring consolidation to the industry. However, Japan's passenger rail stocks declined along with the wider Japanese market, as a pledge by the Japanese Prime Minister to raise consumption taxes in 2017 dented domestic sentiment.

Latin America was the best performing region. Gains were led by Brazil's utilities and toll roads on the view that unpopular president Dilma Rousseff may face impeachment, and that her left-leaning government could be replaced by a more business-friendly regime. Japan's (flat) infrastructure underperformed for reasons mentioned above.

## Fund review

In SGD terms, the Fund returned 3.1% in March, 40 bps behind of its benchmark index.

The best performing stock in the portfolio was Columbia Pipeline Group, which became the latest beneficiary of the strengthening infrastructure M&A cycle after receiving a US$13 billion takeover bid from larger Canadian peer TransCanada. Columbia's pipeline projects, which connect prolific natural gas basins in the Marcellus Shale production area with the US Gulf Coast, offer attractive long term growth potential.

Emerging Markets infrastructure performed well. China port operators COSCO Pacific and China Merchants Ports rebounded on improved sentiment. COSCO Pacific is due to pay shareholders a generous special dividend of HK$0.80 (representing an 8% yield). US-listed electric utility AES Corp, whose globally diversified portfolio includes assets in Brazil and Chile, was lifted by improving sentiment towards Latin America. Brazilian water utility SABESP was buoyed by recovering water reservoirs and consensus-beating fourth quarter earnings results, driven by higher volumes and effective cost control. In the toll road sector, advances were led by China's Jiangsu Expressway and Brazil's CCR.

Mobile towers rose on continued evidence of structural growth in demand for mobile data. Telecom equipment maker Cisco Systems expects global mobile data traffic to grow by an average rate of 53% p.a. between 2015 and 2020. American Tower and SBA Communications, which derive significant earnings from overseas towers, outperformed US-focused Crown Castle as strengthening EM currencies lent an additional tailwind to ex-US earnings.

Utilities performed well on the view that an accommodative US Federal Reserve would keep interest rates lower for longer than had previously been assumed, increasing the appeal of the predictable income streams generated by this sector. Long-awaited approval for its takeover of Pepco gave Exelon an extra boost. The transaction will increase the proportion of its earnings being derived from regulated sources, and makes Exelon the largest US electricity utility by number of customers (U.S. Energy Information Administration data). UGI Corp, Alliant Energy, Duke Energy, SSE and Power Assets Holdings also recorded significant share price gains.

The worst performing stock in the portfolio was a small stake in Italian mobile tower operator Inwit, which dropped after a period of strong performance. The company is engaged in takeover talks with larger peers such as Spain's Cellnex Telecom (not held) and Italy's EI Towers (not held). Reports that Spain's Telefonica and Germany's Deutsche Telekom are both considering IPOs of their mobile tower assets represent additional expansion potential for the listed European tower sector.

Other laggards in an otherwise positive month included Kinder Morgan, which declined as capex cuts by upstream oil and gas companies weighed on the pipeline sector, and East Japan Railway as broad-based falls in the Japanese market overshadowed its solid February passenger revenue growth numbers.

# Outlook

The Fund invests in a wide 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. The Fund generated substantial positive returns and outperformed global equities by over 10% in the first quarter of 2016. While this performance has been encouraging, it partly reflects a recovery from lacklustre performance in the second half of 2015.

Our investment process continues to favour Toll roads and Mobile towers. Toll roads have robust core franchises, are trading at attractive valuations and are paying well-backed dividend yields of between 4% and 6%.  Cash generative mobile towers continue to benefit from structural growth in demand for mobile data, which is putting telecom companies under ongoing pressure to improve network quality and capacity.

Although US freight rail stocks have faced negative earnings revisions, these high quality companies are trading at undemanding valuations. In our view, the market's focus on short term weakness has caused it to overlook the strength in core pricing, ongoing improvements in efficiency and the capacity and willingness to carry out share buy-backs across this sector.

Conversely, recent M&A activity has pushed some utilities to valuation levels that are difficult to justify on fundamentals. Asia-Pacific airports are also trading on optimistic valuations, driven by investor enthusiasm for recent rapid growth in Chinese passenger numbers. As a result we have taken a cautious approach towards these sectors.