First Sentier Global Listed Infrastructure Fund Monthly review and outlook

First Sentier Investors

Monthly Review and Outlook | September 2022

Market review

Global Listed Infrastructure fell in September. Concerns that central banks may need to raise interest rates further than previously anticipated, in order to curb inflation, caused widespread turbulence throughout financial markets. The best performing infrastructure sectors included Airports (-7%), as generally healthy passenger volumes provided evidence that global travel conditions were continuing to normalise. The ports, satellites and merchant power operators included within the Other (-7%) sector also fared relatively well. The worst performing infrastructure sector was the bond yield sensitive Towers / Data Centres (-15%). During the month the US 10-year bond yield rose from 3.2% to 3.8% - its highest level in over a decade.

The best performing infrastructure region was Japan (-5%); the country's passenger rail stocks gained as travel restrictions for tourists visiting the country were eased. The worst performing infrastructure region was the United Kingdom (-14%), where the government's announcement of a large debt-financed package of tax cuts triggered a sharp market reaction.

Fund performance

The Fund returned -7.8% after fees in September[1], 137 basis points ahead of the FTSE Global Core Infrastructure 50/50 TR Index (SGD).

The best performing stock in the portfolio was US Liquefied Natural Gas (LNG) exporter Cheniere Energy (+4%), as continued strong global demand for reliable energy sources enabled the stock to buck the falling markets trend. During the month the company raised its earnings guidance for the 2022 financial year, reflecting higher margins on its LNG sales. Investors also welcomed a revised capital allocation plan, which will further strengthen the company's balance sheet as well as increasing cash returns to shareholders between 2022 and 2026. DT Midstream (-5%), which operates a portfolio of high quality natural gas-focused storage and transportation assets, also held up relatively well. During the month the company acquired a controlling stake in the ~420km Millennium Pipeline, which connects Northeast US natural gas sources to New York and New England utility and power plant markets.

Better performers within the transport infrastructure space included West Japan Railway (+3%), which operates conventional rail and shinkansen (bullet train) services in the western half of Japan's main island; and Mexican toll road company PINFRA (-1%). West Japan Railway gained after the cap on daily arrivals into Japan was raised from 20,000 to 50,000, and on the news that visa requirements for tourists would be relaxed from mid-October. PINFRA was supported by its undemanding valuation multiples and the appeal of its healthy balance sheet. Republic Services (-4%), the second largest waste company in the USA, also fared reasonably well. Investors were drawn to its essential service nature and strong pricing power, supported by inflation-linked contracts with many of its customers.

The worst performing stock in the portfolio was Danish-listed global renewables developer Ørsted (-16%) which underperformed against a backdrop of heightened volatility in energy markets, and worry about political risk as UK and European governments seek to curb the impact of rising energy prices on customer bills. The longer term thesis that this company is positioned to benefit from growth in renewables development, underpinned by national net zero commitments, remains intact. Falls from a number of the portfolio's regulated utility holdings, including US operators Dominion Energy (-15%) and Xcel Energy (-13%) appear to have been driven by a combination of concerns for rising interest rates, and profit-taking after relatively strong performance so far this year.

American freight rail operators CSX Corp (-16%) and Norfolk Southern (-14%) dropped on concerns that a potential economic slowdown may affect haulage volumes. Large-cap US transportation and logistics company FedEx (-29%, not in our Focus List) announced worse-than-expected preliminary earnings numbers, citing weakening global demand. This negative read-through weighed on sentiment towards the freight rail sector.

US mobile tower operators American Tower (-15%) and SBA Communications (-12%) also fell, despite a healthy operating environment as US telecom firms continue to invest in their networks to support the 5G rollout. While structural growth in demand for mobile data is expected to continue to underpin steady earnings growth for these stocks, tower operators are typically sensitive to the direction of interest rates. Italian peer Inwit (-3%) held up relatively well, on the view that its inflation-linked contracts would be supportive of earnings in the current environment. Reports that private equity firm KKR and unlisted infrastructure manager Global Infrastructure Partners were competing for a stake in German tower operator Vantage Towers (+2%, not held), provided the latest reminder of the possibility of further consolidation within the European towers space.

[1] Fund performance is based on the Singapore unit trust, net of fees, expressed in SGD terms. All stock and sector performance data expressed in local currency terms. Source: Bloomberg.

Fund activity

A position was built in ENN Energy, a Chinese gas distribution company run by an experienced and well regarded management team. The Chinese gas distribution market is on a structural growth trajectory, underpinned by a national clean energy drive and an increasing urbanisation rate. Against this supportive backdrop, ENN has demonstrated an ability to expand its high return business model across China. The stock was added to the portfolio as a period of share price underperformance presented an appealing entry level.

Market outlook and fund positioning

The Fund invests in a range of listed infrastructure assets including toll roads, airports, railroads, utilities and renewables, energy midstream, wireless towers and data centres. 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.

Toll roads represent the portfolio's largest sector overweight, via positions in European, Asia Pacific and Latin American operators. We believe these companies represent exceptional value at current levels, with traffic volumes (particularly car traffic) likely to prove resilient if economic conditions deteriorate. Toll roads are also likely to fare relatively well in a higher inflation environment. Many toll roads have concession agreements that specify how prices can be increased, with an option to follow the inflation rate or an agreed percentage – whichever is higher.

The portfolio is also overweight Utilities / Renewables. The Fund's focus is on companies with the scope to derive steady, low risk earnings growth by replacing old fossil fuel power plants with renewables, and by upgrading and expanding the networks needed to connect these new power sources to the end user. Technology advances and lower costs for utility-scale battery storage will enable renewables to represent an ever-greater share of the overall electricity generation mix. In the medium term, the roll-out of electric vehicles is expected to provide an additional boost to utilities – first via investment opportunities associated with linking EV charging stations to the grid; and then via higher overall demand for electricity.

The Inflation Reduction Act (IRA), which includes a broad range of proposals in support of renewables and low carbon energy sources and was signed into law in August, represents a material tailwind for these themes within the US. During our company meetings this month, US utility management teams made strongly positive comments about the IRA, noting the extent to which it reduces the cost of new solar and wind build-out and supports investment in this area.

The portfolio is underweight Towers / DCs. We still expect the sector to be a beneficiary of structural growth in demand for mobile data, and for earnings to prove relatively resilient in the event of a slowing economy. However, further interest rate rises could represent a headwind to valuation multiples in the near term, and to interest expense in the medium term. Underweight exposure to the Energy Midstream sector has been maintained. Strong gains across the sector have moved these stocks to lower rankings within our investment process; and we remain conscious of the structural headwinds that Net Zero initiatives may present to these stocks.

Source : Company data, First Sentier Investors, as of 30 September 2022.