# First Sentier Global Listed Infrastructure Fund Monthly review and outlook

First Sentier Investors

Monthly Review and Outlook | December 2023

## Market review

Global Listed Infrastructure ended the calendar year on a positive note, aided by a growing consensus that interest rate cuts were likely in 2024. The best performing infrastructure sectors were Other (+14%) and Airports (+8%). The ports, satellites and merchant power operators that make up the Other sector were led higher by EM port stocks. Airports were buoyed by positive regulatory developments for Mexican operators. The worst performing infrastructure sector was Energy Midstream (-1%), which dipped following strong gains earlier in the year. Declining oil and natural gas prices also weighed on sentiment towards the sector.

The best performing infrastructure region was Latin America (+10%), owing primarily to strong gains for Mexico's airports. The worst performing infrastructure region was the UK (+1%), reflecting muted gains for its electric and water utility stocks.

## Fund performance

The Fund returned +3.3% after fees in December[1], in line with the FTSE Global Core Infrastructure 50/50 TR Index (SGD).

The best performing stock in the portfolio was Mexican airport operator ASUR (+21%), which operates sixteen airports throughout Mexico, Colombia and Puerto Rico, including Cancun International Airport. The company's share price rallied sharply after details emerged of favourable terms for its 2024 - 2028 regulatory period, including a substantial increase in the maximum tariff it is permitted to charge airlines. The move eased recent concerns that the government was seeking to reduce profits within the sector. Peer GAP (+14%), which operates twelve airports in Mexico's Pacific region as well as two airports in Jamaica, was also positively affected by the news. PINFRA (+9%), which operates a portfolio of 27 toll roads concentrated primarily around Mexico City, rose on the perception of reduced political risk for Mexican concession companies such as toll roads and airports.

Pennsylvania-based gas utility UGI Corp (+14%) rose after the departure of its CEO raised hopes of a fresh strategic direction for the business. The company consists of four distinct segments; regulated gas utilities in Pennsylvania and West Virginia; energy midstream in the Appalachia region; propane distribution in the US (AmeriGas Propane); and propane distribution in Europe (UGI International). Under new leadership, we believe there is potential for the propane distribution businesses to be sold. This would enable the company to focus on its core utility and energy midstream segments.

US west coast freight rail operator Union Pacific (+10%) continued its recent strong run. The company has observed improving haulage volumes, increasing train velocity and lower headcount since new CEO Jim Vena was appointed at the end of July 2023. US east coast peers Norfolk Southern (+8%) and CSX Corp (+7%) also gained on hopes of a more favourable operating environment in 2024.

Transurban (+8%), whose toll road networks enjoy dominant market positions across Sydney, Melbourne and Brisbane, was supported by robust traffic volumes, lower bond yields and the appeal of its healthy 4.4% dividend yield. Brazil's largest toll road operator CCR (+5%) received positive regulatory news. A "financial rebalancing" measure for its ViaQuatro metro line concession in São Paulo, to make up for lower demand seen during the height of the COVID-19 pandemic, is expected to be R$683 million (~US$140 million), equivalent to around 2.5% of CCR's market capitalisation.

The worst performing stock in the portfolio was Beijing Airport (-19%), which lagged as the Chinese airline passenger recovery remained slower than expected. Retail / duty free spending levels at the airport have also disappointed. Flughafen Zurich (-5%) underperformed on concerns that Swiss (the main airline for Zurich) has a relatively high proportion of aircraft that use Pratt & Whitney engines. In recent years, issues with these engines have resulted in additional grounding and inspection requirements.

The portfolio's other main area of weakness was in the energy midstream space. Cheniere Energy (-6%), the largest US Liquefied Natural Gas (LNG) exporter, declined as investors took profits following strong ytd gains. The company's robust earnings profile is underpinned by long-term contracts with reliable counterparties. Houston-based Targa Resources (-4%) and natural gas-focused DT Midstream (-3%) also declined, having outperformed earlier in the year.

## Fund activity

A position was initiated in regulated US electric utility Exelon. Based in Chicago, the company's transmission and distribution networks service over 10 million customers across the US Midwest and Eastern Seaboard. An unfavourable regulatory outcome for the company's Illinois service territory (which represents around a third of the company's rate base) saw its share price fall, creating an appealing entry point for the Fund.

A position in US waste management company Republic Services was sold during the month. Strong share price gains since the position was initiated in early 2021 reduced mispricing and moved the stock to a lower ranking within our investment process. A position in regulated US electric utility Pinnacle West was also

[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.

divested, on concerns that future earnings may be affected by a challenging regulatory environment in its Arizona service territory.

## 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 remain the portfolio's largest sector overweight. These companies have benefited from a shift towards cars and away from public transport since the COVID-19 pandemic. To date, inflation-linked toll increases have had little impact on demand. Strong operating leverage (ie largely fixed costs as sales increase) has proved supportive of earnings growth. From here, we believe that improvements made to toll road networks in recent years provide scope for further growth in traffic volumes.

A substantial portion of the portfolio consists of utilities / renewables. Following a challenging 2023, these stocks face a more constructive outlook for 2024. Balance sheets are in better shape, customer bill pressures are declining and we could see a re-emergence of M&A activity. Capital expenditure growth should accelerate, reflecting the need for increased resiliency spend and higher electricity usage growth from data centres, industrial on-shoring and electric vehicles. However, this growth is also likely to require increased equity issuance.

The portfolio remains underweight energy midstream. Supportive oil and natural gas prices, robust LNG export levels and a disciplined approach to capital expenditure saw the sector generate strong free cash flow in 2023. This may allow energy midstream companies to increase dividend payments and carry out share buybacks, along with some M&A activity, in 2024. However, following strong share price gains in recent years, we believe that greater mispricing can be found elsewhere within our opportunity set.

The portfolio is also underweight airports. The sector saw a significant increase in passenger volumes during 2023, led by leisure-orientated airports catering to pent-up travel demand. In 2024, we anticipate a recovery in retail spending by Chinese travellers and a gradual improvement in business traffic. Offsetting this to some extent, we are conscious that cost-of-living pressures may now begin to constrain demand for leisure travel.

Source : Company data, First Sentier Investors, as of 31 December 2023.