Global Listed Infrastructure Growth

Likely to Parallel the Growth Trajectory of Listed Real Estate

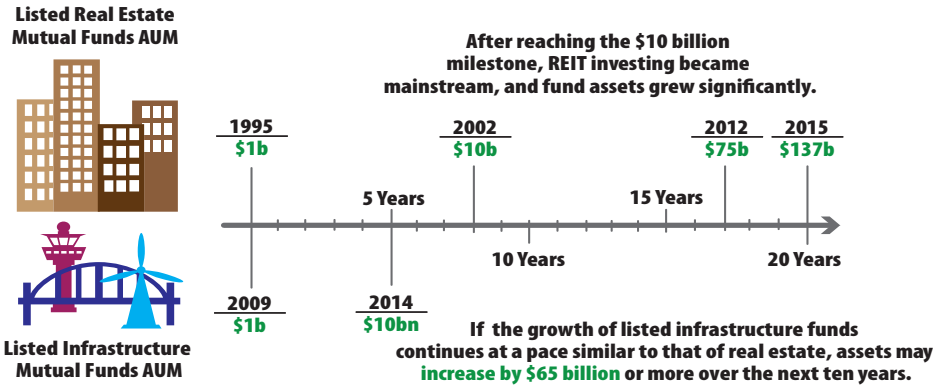
Jeremy Anagnos
CBRE Clarion Securities

Over the past 20 years, an allocation to listed real estate (in the form of REITs) has become widely accepted as an essential part of a balanced investment portfolio. The increase in investor awareness and demand has been driven by a desire for stability of cash flows, consistent income, and competitive risk-adjusted returns. While REITs have become a more mainstream way to invest in real assets, global listed infrastructure (listed infrastructure) has emerged as an alternative way to achieve this, attracting more attention from institutional and other sophisticated long-term investors.

In a sign that investors see infrastructure as a distinct and separate asset class that deserves an allocation within a broadly diversified portfolio, Morningstar has developed a stand-alone category for infrastructure mutual funds that invest more than 60% of their assets in stocks of companies engaged in infrastructure activities. The new infrastructure category became effective at the end of April 2016. In the US open-end mutual fund market, this new Morningstar category currently includes 28 global infrastructure funds with nearly $15 billion of assets under management (AUM).

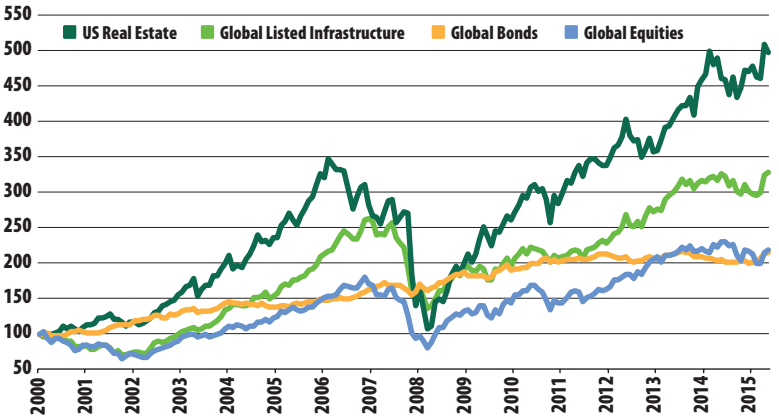
Listed infrastructure, like REITs, may enhance the liquidity, income, and total return potential of a multi-asset portfolio. Despite these similarities and the increased level of attention listed infrastructure has more recently gained, CBRE Clarion Securities' analysis suggests investors' level of awareness of the benefits of the asset class is more than a decade behind that of REITs. Investor demand for listed infrastructure is likely to continue to increase, and total AUM invested in funds dedicated to investing in the space may have a trajectory similar to that of REIT mutual funds over the past several decades (Exhibit 1).

Exhibit 1: Listed Infrastructure Growth May Track Growth of Listed Real Estate



Sources: CBRE Clarion Securities, Morningstar Direct
Notes: Data are as of Dec. 31, 2015. According to Morningstar, real estate portfolios invest primarily in REITs of various types in the US. REITs are companies that develop and manage real estate properties. Infrastructure equity funds invest more than 60% of their assets in stocks of companies engaged in infrastructure activities.

Exhibit 2: Historical Returns Versus US REITs, Global Equities, and Global Bonds



Sources: Global Listed Infrastructure: March 1, 2012, through Feb. 28, 2015, the UBS Global Infrastructure & Utilities 50/50 Index; beginning March 1, 2015, the FTSE Global Core Infrastructure 50/50 Index; US Real Estate: MSCI U.S. REIT Index; Global Bonds: Barclays Global Aggregate Bond Index; Global Equities: MSCI ACWI IMI Index as of April 30, 2016.

Listed Infrastructure Is an Expanding Global Opportunity Set

Infrastructure provides the structures and systems that are essential for society to function. It consists of physical assets that are costly and difficult to replace. Such assets often benefit from monopolies and inelastic demand, which are sources of their ability to provide stable cash flows over long periods of time. This means infrastructure is less affected by economic cycles than other investments. Government regulation and oversight often limits competition to infrastructure providers. Some examples of infrastructure include

- **Communications**—fixed-line networks, satellites, wireless towers
- **Oil and gas transport and storage**—gathering and processing facilities, liquid terminals, LNG facilities, long-haul pipelines
- **Transportation**—airports, ports, railroads, toll roads
- **Utilities**—electric distribution, electric transmission lines, gas distribution pipelines, renewable energy facilities, water distribution systems

The wealth of global infrastructure opportunities has expanded greatly over the past 20 years, as governments have increased the private sector's role. The core infrastructure universe identified by CBRE Clarion has grown from about $400 billion in 1995 to $3.1 trillion in 2016, including more than 400 companies with assets primarily located in developed markets. Core infrastructure companies are defined as companies that own long-duration infrastructure assets with a stable demand profile and low volatility of cash flows. These companies are identified through an analysis of underlying assets, business models, and investment characteristics.

The investment opportunities for the listed market continue to be supported by the need for enhanced safety, reliability, and efficiency of the aging infrastructure in developed markets as well as the need for new infrastructure to support societies' demand for cleaner energy.

According to the McKinsey & Company research report issued in July 2015 *The Infrastructure Conundrum: Improving Productivity,* more than $57 trillion is needed to fund global infrastructure projects in the coming years. This suggests that there'll be a good supply of attractive projects in regions that range from developed to emerging-market countries. The growing need for investment increasingly sourced from private investors and public companies is likely to encourage the rise of global infrastructure as an asset class.

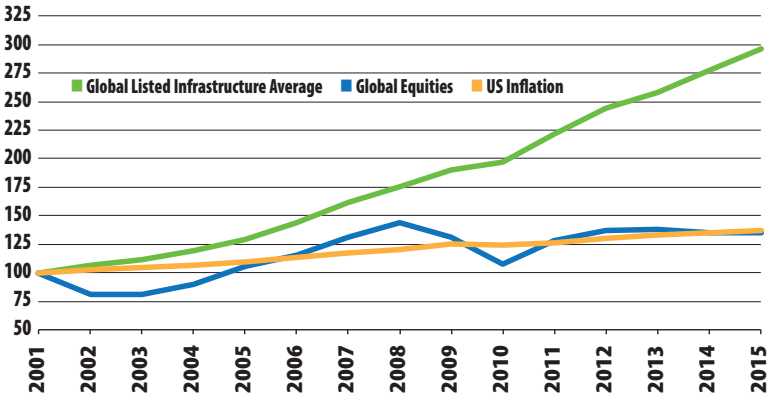
The Case for Investment

Listed infrastructure appeals to investors in many ways. Because it has a history of attractive returns and volatility, it has historically contributed to portfolio diversification and risk-adjusted returns. Its yields may provide steady returns that provide investors a real return that often rises with inflation, according to the underlying assets' long-lived contracts. Infrastructure's total return is anchored by predictable cash flows and attractive dividends.

Attractive Historical Returns

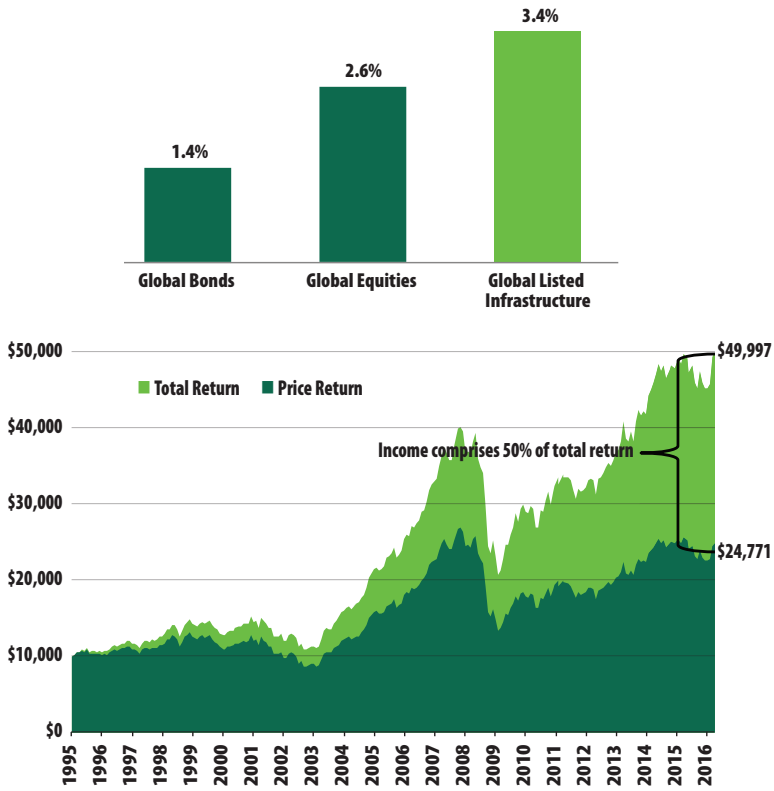
Listed infrastructure has historically provided attractive returns with less volatility than stocks and bonds. Strictly in terms of returns, it outperformed global stocks and global bonds over the 15 years ending April 30, 2016 (Exhibit 2). Over that period, the annualized total return of listed infrastructure was 8.3%

Exhibit 3: Listed Infrastructure Operating Earnings Growth Versus Global Equities and Inflation



Sources: CBRE Clarion Global Infrastructure investable universe, MSCI AWCI Index, and US Consumer Price Index
Notes: Data are as of Dec. 31, 2015. For comparison purposes, company operating earnings and the US Consumer Price Index values were rebased to 100 on Dec. 31, 2000.

Exhibit 4: Listed Infrastructure Offers Attractive Dividend Yields That Are a Significant Component of Historical Total Return



Sources: Global Bonds: Barclays Global Aggregate Bond Index; Global Equities: MSCI ACWI IMI Index; Global Infrastructure: March 1, 2012 through Feb. 28, 2015, the UBS Global Infrastructure & Utilities 50/50 Index; beginning March 1, 2015, the FTSE Global Core Infrastructure 50/50 Index as of April 30, 2016.

versus 11.2%, 5.8%, and 5.4% for US REITs, global stocks, and global bonds, respectively.

Earnings Stability and Attractive Yields

Listed infrastructure historically has generated relatively predictable and rising cash flows across market cycles, as in the period 2001 to the present (Exhibit 3). Listed infrastructure's relatively stable and predictable cash flows rest partly on the long-lived contractual revenue streams that make the yields on this asset class attractive. Moreover, demand for the essential services provided by infrastructure may remain stable regardless of economic weakness. As a result, listed infrastructure's cash flows are less vulnerable to gyrations caused by unexpected world events.

Infrastructure's returns come partly from appreciation from rising investment and partly from dividend yields. Listed infrastructure's dividend yields are greater than those of global stocks and bonds. Dividends have accounted for approximately 50% of the total return of listed infrastructure over the past decade (Exhibit 4).

A Built-in Mechanism for Growth And Inflation Protection

Infrastructure cash flows and dividends benefit from contractually driven, inflation-linked revenue growth, which may provide a long-term hedge against inflation and rising interest rates. For example, toll road assets may offer inflation protection as long-term contracts regarding the tariffs are typically tied explicitly to inflation. In other instances, such as regulated utilities in the UK and Italy, returns are set based on real returns rather than nominal returns, again allowing for a direct link to inflation.

In addition to inflation-linked revenue, infrastructure companies grow revenues and income through capital expenditures to upgrade, improve, or enhance existing infrastructure. Such spending offers them an opportunity to earn a rate of return on these investments in excess of their cost of capital, and drives cash flow growth. Regulators typically establish the rate of return such infrastructure companies can earn on their capital investments, which has typically been higher than the companies' cost of capital.

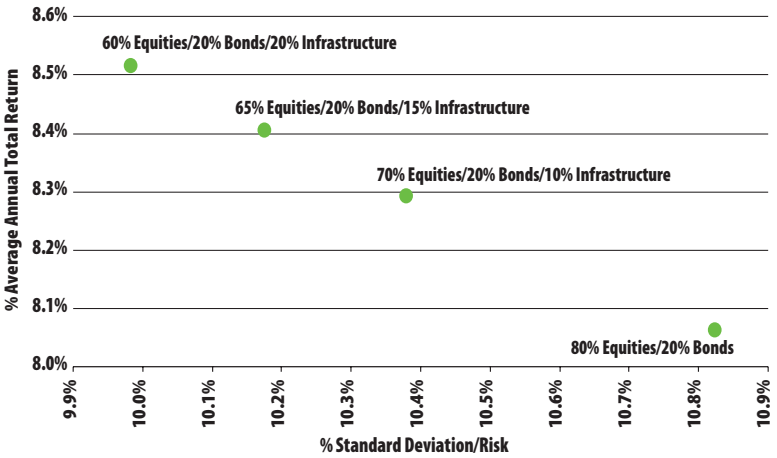
Portfolio Diversification: Attractive Risk-Adjusted Returns

The combination of attractive returns and lower volatility means that listed infrastructure may provide stability and reduce portfolio risk as part of a well-diversified portfolio. Adding listed infrastructure, while reducing the allocation to global equities, may enhance a global portfolio's risk-adjusted returns (Exhibit 5).

Investor acceptance of this growing asset class is gaining momentum because of investors' continued desire for exposure to income-producing real asset securities and the risk-adjusted benefits to a mixed-asset portfolio. Investors also appreciate the income and diversification potential of this asset class, along with the transparency and liquidity of listed infrastructure. ■

Jeremy Anagnos is Chief Investment Officer, Infrastructure, at CBRE Clarion Securities.

Exhibit 5: Listed Infrastructure's Attractive Risk-Adjusted Return



Sources: Global Bonds: Barclays Global Aggregate Bond Index, Global Equities: S&P Developed BMI Index; Global Infrastructure: UBS Global Infrastructure & Utilities 50/50 Index; beginning March 1, 2015, FTSE Global Core Infrastructure 50/50 Index
Notes: All data are annualized and calculated for the period beginning Jan. 1, 2003, and ending April 30, 2016. Standard deviation measures the dispersion or uncertainty in a random variable (in this case, investment returns). It measures the degree of variation of returns around the mean (average) return. All indices are hedged to USD.