COHEN & STEERS

Listed Infrastructure and COVID-19:
Some Sectors Heavily Impacted, but Long-Term Defensive Story Intact

Overview

The economic shock from COVID-19 has been sudden and severe, exacerbated by the steep decline in oil prices, which has added to the strain on credit markets. This could last much longer than people expect, increasing the risk of tighter financial conditions that could severely impact companies with weak balance sheets.

Our base assumption is that a) the U.S. economy experiences a sharp contraction in the second quarter, followed by a modest rebound in the third quarter, b) the Eurozone and Japan post anemic or negative growth through the first half, c) China begins to reaccelerate in response to declining new cases and economic stimulus, and d) the global economy enters a recession, ramping up in the second half as activity comes back online.

This scenario depends on social distancing measures lasting through May, central banks providing liquidity to markets, and significant fiscal stimulus. Without one or more of those conditions, we could have a more pronounced recession.

> We believe listed infrastructure is generally well prepared to manage through this challenging period based on companies' relatively stable cash flows, healthy balance sheets and attractive dividends.

Highlights

1. **How recession risk is affecting listed infrastructure.** Listed infrastructure has only modestly outperformed the broad global equity market year to date, as transportation-related subsectors and midstream energy have been particularly weak in the current environment. We expect growth in these subsectors will be negatively impacted and, in some cases, balance sheets will be tested. Other sectors such as cell towers and utilities should be less affected.

2. **This is not 2008.** We believe risks for infrastructure companies have declined significantly over the last decade: balance sheets are healthier, regulatory environments have improved and there are far fewer externally managed companies, which generally used greater leverage to drive growth.

3. **What we are doing in our portfolios.** We have been de-risking our portfolios, reducing energy- and transportation-related equities early on, in favor of less economically sensitive businesses. We have increased weightings in higher-quality, larger-capitalization companies with relatively predictable cash flows and strong balance sheets, with an emphasis on businesses that would be least affected by a prolonged activity downturn.

How Recession Risk Is Affecting Listed Infrastructure

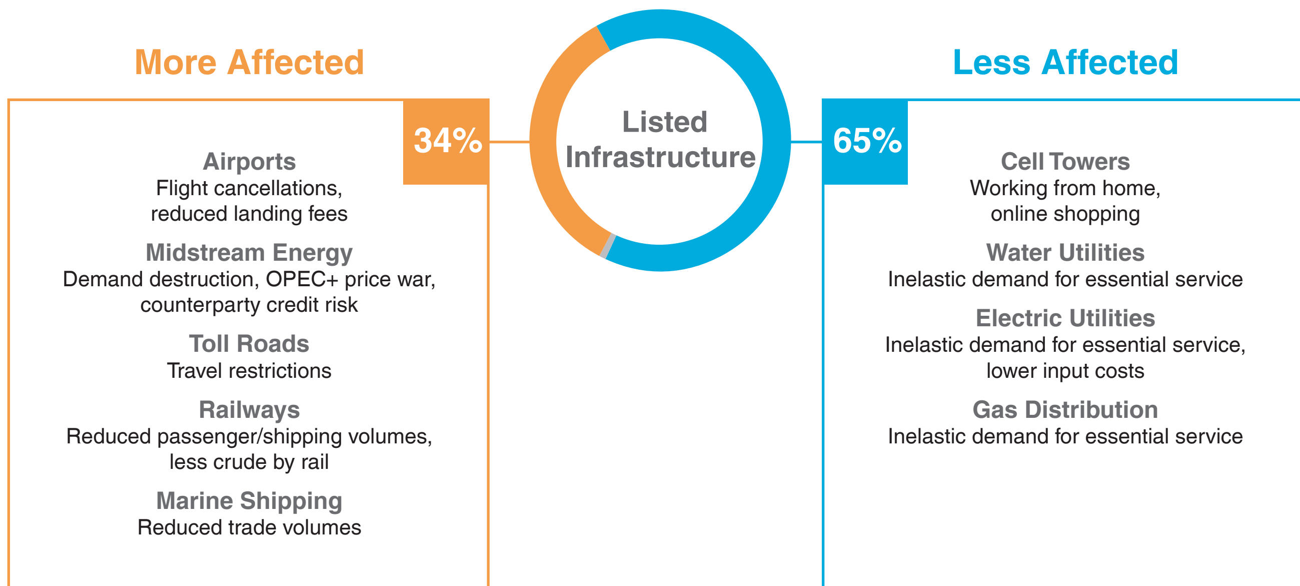
Airports: With flight schedules being trimmed globally, airlines are anticipating a substantial decline in revenue in the next several months. Airport operators will experience reduced revenues from lower takeoff and landing fees, airport movement charges and retail sales (the latter generally contributing 25–50% of total revenues). In some regions, governments are asking airports to cut landing fees and gate use requirements. Differences in balance sheet strength and liquidity vary significantly by company, with some, such as those based in Mexico, operating with low leverage or in net cash positions, while others (particularly those in Europe) have higher leverage.

Toll roads: Travel restrictions and the slowdown in activity levels have directly impacted toll roads. Government policies could further weigh on certain companies in the short term. In China, for instance, the government has suspended tolls on roads, bridges and tunnels. Financial positioning varies by country and company, and we are focusing on those businesses that can withstand an extended adverse impact on traffic volumes.

Railways: Freight rail operators are contending with lower shipping volumes due to reduced economic activity. For some North American companies, this could also include a reduction in crude oil shipments by rail. Lockdown efforts to slow the spread of COVID-19 are likewise impacting passenger rail traffic in other regions, such as Japan. However, both freight and passenger railways benefit from relatively strong balance sheet and liquidity positions today.

Midstream energy: The steep decline in crude oil prices is forcing producers to curtail output, raising concerns about midstream energy throughput volumes and contract/counterparty risk. The commodity price weakness has had the most significant impact on gathering and processing midstream companies, which have assets closer to the wellhead. This is particularly impacting companies with assets in basins outside the Permian, where extraction costs are generally higher.

EXHIBIT 1: Listed Infrastructure and Social Distancing



At March 17, 2020. Source: Cohen & Steers.

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Towers: Cell towers should continue to see solid secular demand due to rapid growth in data usage with the adoption of social distancing policies such as working/learning from home. However, tower companies could see some impact in the short term from slower decision-making on capital spending by wireless carriers.

Utilities: Regardless of the strength of the economy, people will continue to heat their homes, take showers, turn on their lights and watch television. Water, electric and gas utilities should all enjoy fairly stable demand for their services. For certain gas and electric utilities, commodity price weakness may even be a near-term positive, given a potential lag in customer rate adjustments.

This Is Not 2008

A healthier underlying economy and accommodative policies. Though we expect the near-term economic disruption to be significant, this slowdown is not driven by typical recession triggers: economic overheating and monetary policy tightening. Contrasting with the incremental easing measures enacted in 2008, central banks and governments are pushing forward with aggressive monetary and fiscal offsets to help limit the damage. For example, the Federal Reserve has cut the fed funds rate to zero, has promised $700 billion in bond purchases and has established a lending facility to provide liquidity to the short-term commercial debt market, helping to ease strains in overnight lending. Central banks in other countries have implemented similarly substantive measures to combat the sudden strain on credit markets.

Reduced leverage and stronger balance sheets. Many infrastructure companies have meaningfully strengthened their balance sheets over the last decade and, in our view, are largely in a better position to manage through a downturn. For instance, European utilities were forced to recapitalize following the global financial crisis. Likewise, after oil prices slumped in 2015–16, midstream energy companies adopted new operating and financing models that focused on maintaining stronger balance sheets, with less reliance on capital markets to fund growth projects.

Fewer externally managed investment vehicles. These publicly traded companies contract out management functions, which frequently resulted in conflicts of interests, governance issues and excessive reliance on debt to fuel growth. Today's owner/operators generally have better alignment of interests with shareholders and have more efficient capital allocation. .

What We Are Doing in Our Portfolios

- **Focusing on less economically sensitive sectors:** In general, we have taken a more conservative approach with our portfolios in recent weeks, reducing our exposure to sectors levered to economic growth.
- **Positive communications infrastructure thesis remains intact:** Tower companies have predictable cash flow profiles (long-term contracts with tenants who typically renew leases at a 98–99% rate), steep barriers to entry and well-defined growth prospects.
- **Adding selectively to utilities:** We have selectively increased our weighting in utilities. In particular, we favor water utilities, which benefit from relatively strong growth and attractive environmental profiles. While we have increased electric utility positions, we remain underweight the sector due to regulatory and political risks and less attractive relative valuations. We also remain underweight gas distribution companies, although we see a near-term opportunity in Japanese gas utilities, which should enjoy better margins due to sharply lower input costs, as the fees they charge customers are regulated and only periodically subject to adjustment.

- **Midstream energy to remain challenged, although energy storage is a potential opportunity:** In recent months, we have been reducing our midstream energy weighting based on our view that consistently lower energy commodity prices would weaken pipeline customers' financial and credit profiles. The challenged energy supply/demand balance was further weakened by the breakdown of OPEC+ negotiations, as well as by the demand destruction caused by the COVID-19–driven activity slowdown. In this context, we favor larger-capitalization diversified midstream companies with strong balance sheet and liquidity profiles. Those that are further downstream (refinery-linked and storage businesses) may benefit from low energy prices and can have inflation-protected contracts. With oil production in many shale basins unprofitable at current prices, we continue to monitor counterparty credit risk, and we have minimized exposure to companies with perceived liquidity issues and debt refinancing risks.
- **Cautious on transportation infrastructure given the potential for an extended activity slowdown.** We remain underweight European airports based on the severe fundamental and financial impact of reduced air travel. Although we believe freight rails represent an attractive long-term investment, we have moved to an underweight position given out updated expectation of continued weakness in freight volumes and we have similarly reduced our exposure to Japanese passenger rails. We continue to maintain an underweight in marine ports.

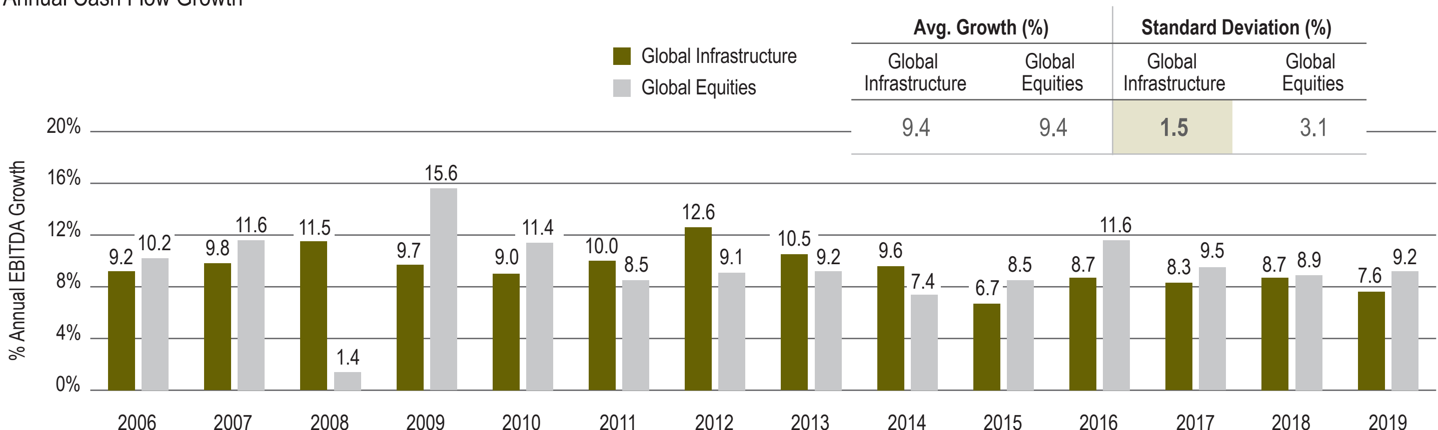
What Should Listed Infrastructure Investors Do?

Over the long term, listed infrastructure has been an effective portfolio diversifier, historically delivering equity-like returns that have been especially resilient in challenging economic environments. Demand for services in many sectors is inelastic, cash flows are relatively predictable, and dividend yields are attractive.

Historically, contracted revenues and inelastic demand have led to relatively stable cash flows for infrastructure, even in periods of economic stress, such as during the 2008 global financial crisis (Exhibit 2).

EXHIBIT 2: Infrastructure Cash Flows Have Been Relatively Consistent, Even in 2008

Annual Cash Flow Growth



Avg. Growth (%)		Standard Deviation (%)	
Global Infrastructure	Global Equities	Global Infrastructure	Global Equities
9.4	9.4	**1.5**	3.1

At March 17, 2020. Source: FTSE, MSCI and FactSet.

Data quoted represents past performance, which is no guarantee of future results. There is no guarantee that any historical trend illustrated above will be repeated in the future, and there is no way to predict precisely when such a trend will begin. There is no guarantee that any market forecast or investment objective set forth in this presentation will be realized. An investor cannot invest directly in an index and index performance does not reflect the deduction of any fees, expenses or taxes. Annual Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) growth percentage is calculated as a weighted average of all constituents in the index; exclusions are applied to constituents with EBITDA growth of +/- 200%. Global Listed Infrastructure is represented by the FTSE Global Core Infrastructure 50/50 Net Tax Index. The index was officially launched on March 31, 2015, however back tested holdings data is available from the index provider starting on December 18, 2012; holdings at that time are held static for periods prior to that date. Global Equities are represented by the MSCI World Index. Holdings data is only available from the index provider starting June 30, 2010, holdings at that time are held static for periods prior to that date. Our total return framework conservatively assumes no multiple expansion. Standard deviation is a measure of the dispersion of a set of data from its mean. The more spread apart the data, the higher the deviation. See pages 6–7 for index definitions and additional disclosures

For historical perspective, following the previous six market corrections of 10% or more, listed infrastructure generally had strong absolute returns in the ensuing three- and six-month periods, on average (Exhibit 3).

EXHIBIT 3: Performance After Market Corrections

						Returns 3 months After the Trough Date			Returns 6 months After the Trough Date		
Cause of the Correction	**Peak Date**	**Trough Date**	**U.S. Equities Selloff**	**Global Equities Selloff**	**Global Listed Infrastructure Selloff**	**U.S. Equities**	**Global Equities**	**Global Listed Infrastructure**	**U.S. Equities**	**Global Equities**	**Global Listed Infrastructure**
"Shocktober" Worldwide Stock Market Downturn	9/20/18	12/24/18	-19.4%	-17.5%	-9.4%	20.0%	16.8%	18.5%	25.2%	21.1%	23.2%
Feb 2018 Correction	1/26/18	2/8/18	-10.1%	-9.0%	-8.3%	6.0%	4.6%	4.7%	11.6%	7.0%	8.8%
"The Great Fall of China" Market Selloff	7/20/15	2/11/16	-13.0%	-16.8%	-16.1%	13.5%	13.2%	16.3%	20.8%	19.7%	24.0%
European Sovereign Debt Crisis	4/29/11	10/3/11	-18.6%	-21.8%	-8.5%	16.9%	12.7%	11.4%	30.1%	23.8%	17.2%
Flash Crash	4/23/10	7/2/10	-15.6%	-14.9%	-9.2%	12.7%	14.8%	16.2%	24.2%	24.5%	20.8%
Global Financial Crisis	10/9/07	3/9/09	-55.3%	-57.4%	-48.3%	39.7%	43.0%	30.0%	52.0%	58.4%	42.8%
Average						**18.1%**	**17.5%**	**16.2%**	**27.3%**	**25.7%**	**22.8%**

At March 17, 2020. Source: Cohen & Steers.

Data quoted represents past performance, which is no guarantee of future results. *An investor cannot invest directly in an index and index performance does not reflect the deduction of any fees, expenses or taxes.* U.S. equities are represented by the Standard & Poor's 500 Index. Global equities are represented by the MSCI World Index net. Global Listed Infrastructure is represented by Dow Jones Brookfield Global Infrastructure Index. See pages 6–7 for index definitions and additional disclosures.

We understand these are unprecedented times and we will continue to provide updates as the situation evolves. In the meantime, please reach out to your Cohen & Steers representative with any questions.

Index Definitions. *An investor cannot invest directly in an index and index performance does not reflect the deduction of any fees, expenses or taxes. Index comparisons have limitations as volatility and other characteristics may differ from a particular investment.*

The Dow Jones Brookfield Global Infrastructure Index is a float-adjusted market-capitalization-weighted index that measures performance of globally domiciled companies that derive more than 70% of their cash flows from infrastructure lines of business.

The FTSE Developed Core Infrastructure 50/50 Index is a market-capitalization-weighted index of infrastructure and infrastructure-related securities in worldwide developed markets. Constituent weights are adjusted semi-annually according to three broad industry sectors: 50% utilities, 30% transportation, and a 20% mix of other sectors, including pipelines, satellites, and telecommunication towers.

The MSCI World Index - net is a free-float-adjusted index that measures performance of large- and mid-capitalization companies representing developed market countries and is net of dividend withholding taxes.

The S&P 500 Index is an unmanaged index of 500 large-capitalization stocks that is frequently used as a general measure of U.S. stock market performance.

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COHEN & STEERS

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