Blending listed and unlisted infrastructure can achieve optimal allocation

Blending listed and unlisted infrastructure strategies can result in diversification benefits and help achieve an optimal allocation, according to research by Simon Wilde of London's Imperial College and the Global Listed Infrastructure Organisation (GLIO).

"We compared the financial risks and returns of listed and unlisted infrastructure, assessing the view that they are not necessarily the same at any one point in time because of the pricing methods," says researcher Simon Wilde. "We then looked at the impact of allocating capital to both vehicles for large, well-diversified investors. To the extent listed and unlisted infrastructure perform differently, there may be diversification benefits from having allocations to both areas."

Ken Robbins, Head of Property & Private Markets at UniSuper, which has used both listed and unlisted vehicles, explains, "At UniSuper, we allocate to specific risk profiles based on the underlying assets rather than through the traditional asset class allocation approach.

"Labelling all infrastructure investments as one category of risk and return, in our view, is inappropriate. We are agnostic when it comes to listed versus unlisted infrastructure and property, as we do not believe being priced daily changes the underlying asset, its income stream or its risk."

Oskar Backman, Investment Manager Real Assets at First Swedish National Pension Fund (AP1), shares the view, "We use the listed companies to gain exposure to infrastructure. We like the transparency and liquidity of the listed companies, but moreover, we are looking at gaining exposure to well managed high-quality underlying infrastructure assets."

Fraser Hughes, CEO at GLIO says, "we believe that unlisted and listed infrastructure go hand-in-hand, enabling investors to gain exposure across a diverse range of infrastructure assets. Any sensible allocation to infrastructure must consider all potential companies/vehicles, on a 'look-through' basis, focusing on the quality of underlying assets, cashflows and management teams."

Proponents of listed infrastructure will be heartened by its strong outperformance; $100 invested in listed infrastructure in June 2003 would have increased 12 years later to $394.

This is significantly higher than the $268 from unlisted infrastructure or $270 from global equities, $154 from bonds and $117 from risk-free assets.

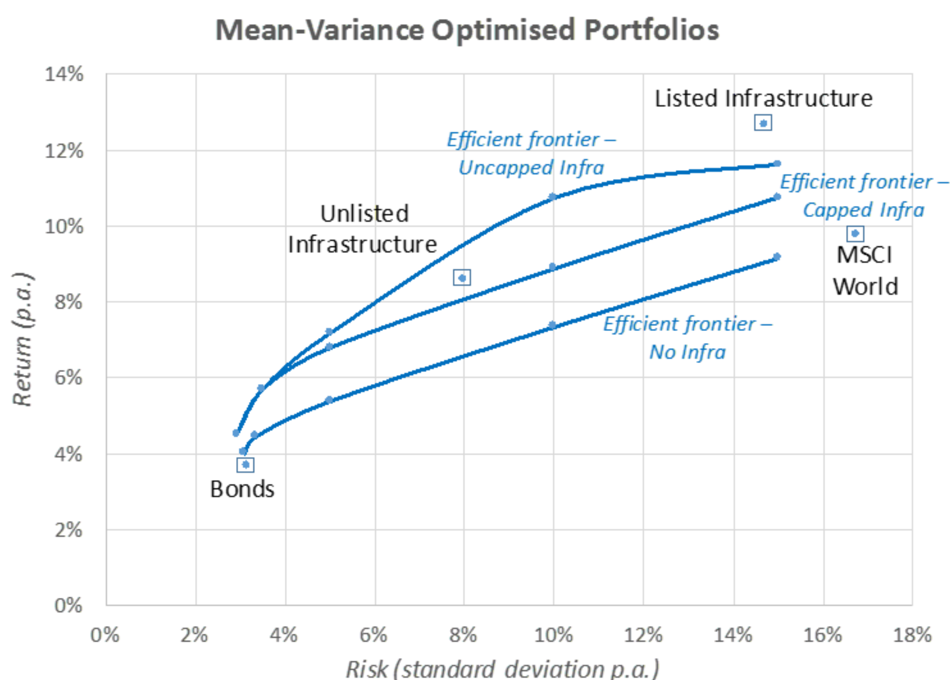
The research also found listed infrastructure returns are more correlated with global equities than unlisted infrastructure, seen by their capital asset pricing model betas of 0.76 and 0.18, contributing to unlisted infrastructure having a higher capital asset pricing model alpha of 5.8%, compared to 4.9% for listed infrastructure.

However, this goes with the caveat that if NAVs systematically understate the true change in market value of funds' assets, then NAV volatility will also be

understated, thus flattering risk-adjusted returns. At the same time, illiquidity of unlisted infrastructure is self-evident and it may be that investors should demand an illiquidity premium, which is not taken into account in the analysis. In addition, time-horizon constrained investors may not be able to consider unlisted funds, or direct investing at all.

Simon Wilde says, "The imperfect correlation of both types of infrastructure, because of the differing valuation methods, and with other asset classes, means there should be a significant diversification benefit from including a blend of infrastructure into an equity and bond portfolio."

Based on sample data from 2003 to 2015, the study found that if an investor is targeting 10% volatility, the best possible return from not allocating to infrastructure is 7.3%. This increases to 8.7% under a 40% capped blended infrastructure allocation. An uncapped blended infrastructure allocation achieves 11%, which is comprised of approximately 50/50 listed and unlisted infrastructure.



Fraser Hughes, GLIO CEO, adds, "as the competition for direct infrastructure assets intensifies, and the amount of dry powder looking for infrastructure exposure swells, an allocation to a diversified portfolio of listed infrastructure, as part of a broader infrastructure allocation makes perfect sense for investors looking for long-term infrastructure investment characteristics."

Simon Wilde concludes, "a better understanding of how the variety of infrastructure vehicles perform and complement each other, is essential to the development of the asset class as a whole. As the GLIO library of infrastructure research and education evolves, investors will be better placed to fully understand the benefits and risks of the full range of infrastructure investment opportunities."

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