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With Infrastructure, Follow the Assets

#wrapperdontmatter

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Highlights

- As with real estate, we believe infrastructure should not be defined by its wrapper but by a set of assets, contract/concession/regulatory structures and investment characteristics.
- Using an appropriate universe focused on core infrastructure characteristics, listed infrastructure has historically exhibited equity-like returns with distinguishing attributes: reduced volatility, downside protection and low correlations to other asset classes.
- Considering the massive need to fund critical infrastructure improvements, we believe both listed and private vehicles will be vital in driving capital formation and presenting investment opportunities in the coming decade.

Listed infrastructure—when defined appropriately—can provide access to unique total-return opportunities with diversifying characteristics.

The trend in 2017: If you don't like the news, just say it's fake. Apparently this approach has crept into the investing world, too.

Amid the tremendous demand for infrastructure investment strategies, there has been much debate over the relative merits of investing through private or public markets. In particular, we have noted a frenzied effort by some research organizations partnered with private equity groups seeking to discredit listed infrastructure.

Their arguments are not new. We've heard them before with commercial real estate in the early 1990s. Twenty five years later, many institutions around the world now employ both listed and private real estate as complements to each other. So why not infrastructure?

For context of this discussion, let's take a look at the current infrastructure investment landscape.

Over the past several years, investors have poured hundreds of billions of dollars into funds promising access to toll roads, airports, power transmission and other infrastructure assets, hoping to capitalize on the enormous need for private infrastructure funding. Yet much of this capital remains idle, as private equity managers are often finding it easier to raise money for an idea than put it to work in a market of finite opportunities.

Infrastructure data provider Preqin estimates that as of June 2017, private equity managers targeting infrastructure had $150 billion in dry powder. Where private investments have been made, they are often changing hands at significant premiums to listed market valuations, due in part to the imbalance of capital available relative to the projects for sale. As they have in the past, we expect some of these managers will look at listed infrastructure companies as potential acquisition targets. In our view, these managers clearly consider the assets owned by listed infrastructure companies as appropriate for their clients' objectives.

Meanwhile, more investors are looking to the listed market as a means of implementing a global infrastructure allocation, both standalone and as a complement to private infrastructure. Through 2016, global assets under management in listed infrastructure strategies reached $86 billion, up from $20 billion in 2011.

In our view, infrastructure should be defined not by its ownership vehicle, or wrapper, but by a specific set of assets and regulated or concession-based structures. We believe a good example is the FTSE Global Core Infrastructure 50/50 Index.

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The FTSE index consists only of companies that own and operate core infrastructure assets, which should prevent dilution of infrastructure characteristics that may occur in a more broadly defined sample set—for example, one that simply relies on industry classification schemes. Furthermore, compared with other listed infrastructure indexes and many private infrastructure funds, the FTSE index is diversified across utilities, transportation and commercial infrastructure, with no outsized regional concentrations.

Through July 2017, the index has returned 10.2% annually since its inception at the end of 2009, compared with 9.3% for the MSCI World—but with 270 basis points lower volatility and 51% downside capture. Moreover, correlations with bonds remain low, while correlations with equities are at their lowest point in years. In our view, those are distinguishing characteristics.

To us, arguing over whether listed or private infrastructure is better misses the point. Both vehicles can offer attractive features, providing investors access to long-lived assets in generally monopolistic industries that have historically generated relatively predictable cash flows, often linked to inflation.

Ultimately, we believe both listed and private vehicles will be vital in raising the tens of trillions of dollars needed in the coming decades to finance critical infrastructure improvements worldwide. That should create opportunities for attractive returns in both markets.

We have already seen the potential for capital formation in listed markets with commercial real estate. Since the start of the modern REIT era in 1991, the global real estate securities market has grown from a $100 billion market cap to roughly $2 trillion today. From a time when the vast majority of institutional real estate allocations targeted private investments, listed real estate is now widely recognized as an effective way to allocate to real estate and is utilized in both institutional and individual portfolios globally.

Similar to real estate, we expect listed infrastructure will continue to gain share in investor portfolios based on its attractive investment characteristics and the ability to efficiently implement globally diversified portfolios.

Several factors may ultimately guide an investor to a private or listed allocation, including liquidity budgets, yield and total-return targets, leverage tolerance and risk appetite. Also, investors may want access to infrastructure themes that may only be available in either the listed or private market. Such considerations are reasonable, in our view…arguments over real and fake infrastructure are not.

Index Definitions. *An investor cannot invest directly in an index and index performance does not reflect the deduction of any fees, expenses or taxes.*
The FTSE Global Core Infrastructure 50/50 Net Tax Index is a market-capitalization-weighted index of worldwide infrastructure and infrastructure-related securities and is net of dividend withholding taxes. 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 utilities sector excludes the subsector generation utilities. The index is free-float market-capitalization-weighted and is reconstituted annually with quarterly rebalances.

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Publication Date: **August 2017.** Copyright © 2017 Cohen & Steers, Inc. All rights reserved.

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