Infrastructure Research

The case for listed infrastructure

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Real assets, including infrastructure, will continue to be important in the asset allocation debate. Even if bond yields were to rise, they will do so gradually and the insurance and pension industry would still struggle to cover its long-term liabilities by investing in bonds. So, despite higher valuations, this in our view still supports a further increase in asset allocation towards real assets in the coming years. The higher operational leverage of infrastructure vs. the higher financial leverage of property makes the former more cyclical. If the rotation to reflation does not fade, infrastructure as a yield alternative could offer more upside in the near term.

Not a clear-cut definition…

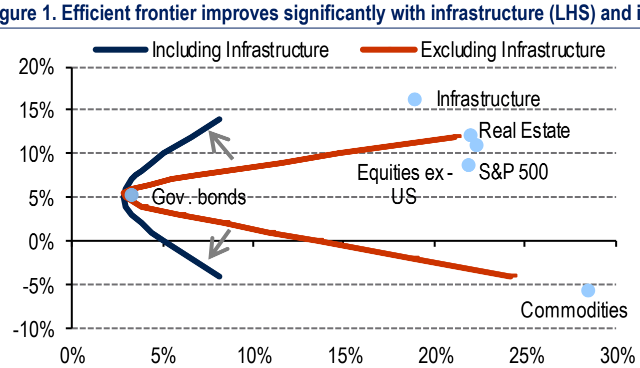
The definition of infrastructure is often a source of discussion. Infrastructure in its broadest sense can include companies that utilize the infrastructure but do not necessarily own, manage or operate it. On the other hand, the "pure-play" infrastructure companies derive the bulk of their operating income from managing/operating the asset. We believe that the characteristics (and attractiveness) of the sector are only visible with a narrow definition.

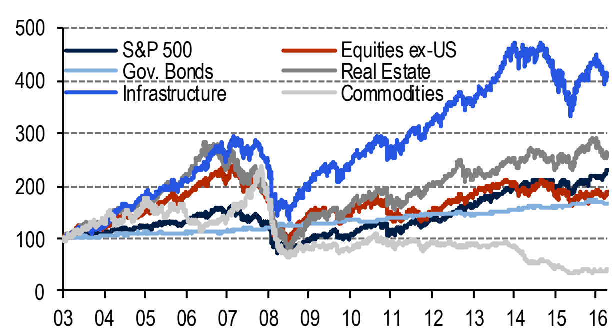
The limited competition and regulation of infrastructure assets result in relatively stable income streams, regardless of the economic cycle, and good visibility on earnings. The assets, often with inflation-linked contracts, benefit from high barriers to entry and relatively inelastic demand.

… For a separate asset class which definitely improves risk / return

Infrastructure has been one of the best performing asset classes since 2003, based on the GPR Pure Infra index. The search for yield has driven share prices in recent years, underpinned by transactional evidence in the direct market. However, infrastructure also outperformed general equities and property in an economic upturn and in the financial crisis. Due to the superior risk-return characteristics (Sharpe Ratio of 0.6), adding infrastructure to a well-diversified portfolio improves the efficient frontier significantly.

Figure 1. Efficient frontier improves significantly with infrastructure (LHS) and index performance since 2003 (RHS)





Source: Bloomberg, GPR, Kempen & Co estimates

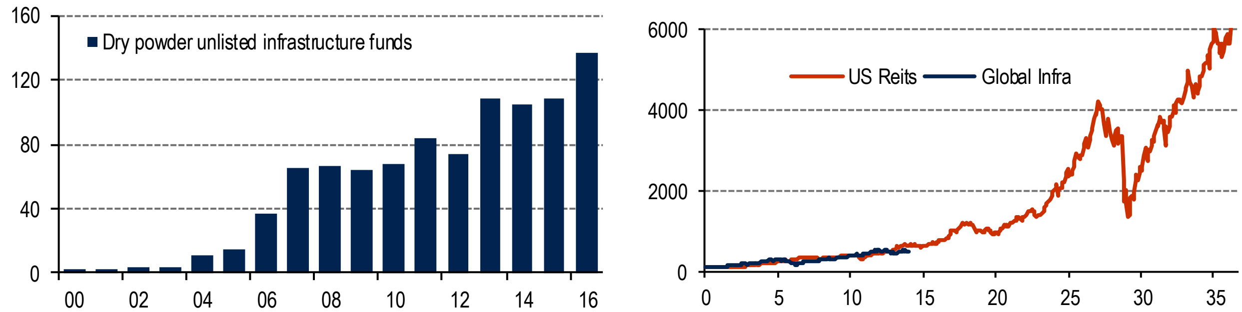
The correlation with general equities and property remains relatively high at 0.7, which is partly explained by the overlap in certain stocks, the larger share of passive investors and macroeconomic events. In addition, the negative correlation to bond yields since the financial crisis explains part of the repricing of infrastructure stocks.

Listed, unlisted or both?

Although infrastructure has been privately owned for centuries, privatization has only gained pace in western European countries since the 1980s, pioneered by the UK. The growth in Assets under Management of unlisted infrastructure investors has accelerated over the last decade. The same trend has been visible in the listed market with a growing number of companies. The 'wall of money' has intensified competition for core infrastructure assets as investment opportunities are limited.

Infrastructure is still a relatively new asset class for listed and unlisted investors alike, but the sector is gaining acceptance as a real asset class. Despite its strong performance, it still offers an attractive investment opportunity in a fast-growing market. The development of the property market, and especially the REIT market since the 1980s, is a good example of the potential of the listed infrastructure market.

Figure 2. Dry Powder of direct infrastructure funds (LHS) and US REITs since 1980 vs. Global infra since 2002 (index since inception = 100, RHS)

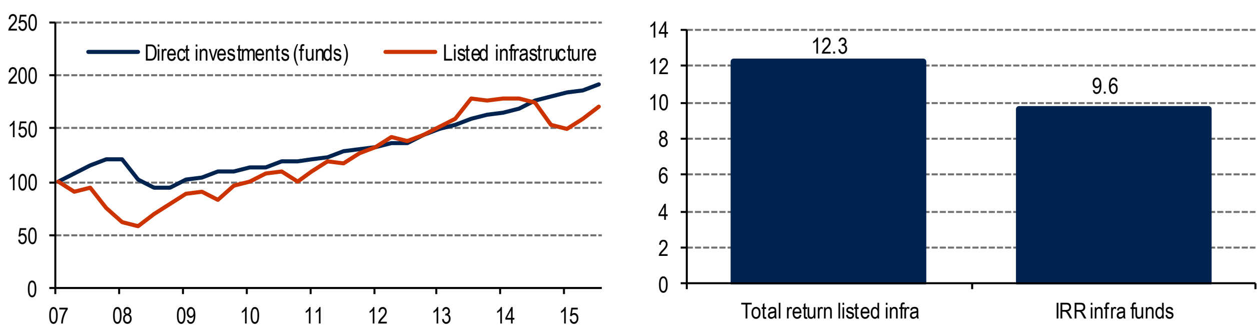


Source: Bloomberg, GPR, Preqin, Kempen & Co estimates

Investors have to decide on their preferred way of gaining exposure to the sector - listed or unlisted. However, in our view, the one does not exclude the other. Dual allocation is common among property investors. The listed market offers liquidity, a diversified global exposure and public-market corporate governance standards. Volatility is arguably lower in the short term in the direct market as returns are smoothed and the listed market tends to overshoot in bear/bull markets. Yet, the characteristics should converge over a longer period.

Even if we start at the last peak in 2007 and include the financial downturn, listed infrastructure reported a 6.5% CAGR total return vs. 8.0% of direct investments. If we lengthen the sample, the 2004-16 12% CAGR total return of listed infrastructure outperforms the 10% of direct infra funds (after costs).

Figure 3. Total return since the last peak in 2007 (LHS) and estimated 2004-16 CAGR total return (RHS)



Source: Bloomberg, IPD, Kempen & Co estimates

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