Are infrastructure funds all that they seem?

by Rebecca Hampson (http://www.etfstream.com/author/rebeccahampson), 28th November 2017

Infrastructure is something that is integral to our day-to-day living. It includes roads, railways, airports, water distribution, gas, oil, communication, schools and hospitals. JP Morgan Asset Management defines it as the essential facilities and services upon which the economic productivity of society depends.

These assets are typically involved in the movement of goods, people, water, and energy and historically these have been unlisted assets, meaning they are not listed or traded on exchange. Investors have typically gained exposure through unlisted funds buying direct stakes in infrastructure assets where they then have a say in how they are managed. Private equity has been a conduit to it.

However, in the last decade an increasing number of companies that own or operate infrastructure assets have become publicly-listed enabling more investors to access infrastructure assets, putting them in their portfolios via passive products. It is this that has brought about the asset class "listed infrastructure".

It is now becoming increasingly popular with investors and with good reason – listed infrastructure as an asset class saw double-digit returns over the last year. The previously unlisted asset class is now available to retail investors with a slew of products such as ETFs launched on infrastructure indices. For example, the SPDR Global Infrastructure ETF (GII), which has a TER of 0.40% and is listed on NYSE Arca has had returns of 22.49% over the last year. Similarly, the iShares Global Infrastructure ETF (INFR), listed on the LSE, has had returns of 9.15%, the TER is 0.65%.

According to data from EDHEC Infrastructure Institute 10 years ago there were three infrastructure ETFs; today there are 39 with an AUM of $57bn.

Listed infrastructure assets also claim to trade like equities, but should – in the long term – perform as the infrastructure market does. Global listed infrastructure also has a lower risk profile than the underlying infrastructure assets and is more liquid. As an asset class it also has a promising outlook with supportive factors, such as growing population and renewable energy to help drive it along.

Considered to be in a multi-decade growth phase it's fair to assume that infrastructure assets will expand over the coming years and therefore getting exposure could be a good idea. It is an uncorrelated asset class, so may work well in a portfolio.

Infra digs

However, listed infrastructure as an asset class raises a few questions and by its very nature doesn't sit all that comfortably. A recent report (The Rise of Fake Infra) from EDHEC Infrastructure Institute found that there is no such thing as a listed infrastructure asset class.

The report reviewed the marketing documentation of 144 listed infrastructure products (both active and passive), which account for 85% of the listed infra sector by AUM and are making near identical claims to private infrastructure products. They offer investors "equity-like returns and (sic) reduced volatility, portfolio diversification, downside protection, predictable cash flows, and predictable returns often linked to inflation, and access to a unique asset class."

Sarah Tame, associate director at EDHECinfra, explains that listed infrastructure accessed by passives clashes with the concept of infrastructure as a whole. In fact, listed infra fund managers are misleading investors in the marketing of these funds."

I'm inclined to agree with this.

Should a market that is crucial to our day-to-day lives and has been the domain of government companies and the private sector suddenly become a listed asset class that anyone can potentially have a say in?

Worryingly, EDHECInfra's report found that the funds don't always invest solely in infrastructure. The list of constituents selected by passive listed infrastructure managers has grown from 167 assets in 2000 to more than 400 stocks in 2017 and not all of these are related to infrastructure. GICS classification reveals stocks in sectors such as: consumer discretionary, real estate, and financials. And when using the ICB classification the research found that non-infra related sectors such as media and travel and leisure were included.

As a result EDHECinfra has contacted the SEC and ESMA to recommend stronger regulatory oversight of these products including the obligation to include the word "listed" in their name to avoid misleading investors, as well as the obligation to include information in the marketing documents and information kits warning investors that listed infrastructure may not deliver the same performance as unlisted infrastructure investments.

There are other issues, though, that investors should also be aware of such as high fees. The high fees are qualified by their claim to offer investors access to a unique asset class. The average TER for passive infrastructure funds is 0.61% compared to 0.17% for US ETFs.

However, it could be the private infrastructure market that will feel the biggest impact. Tame explains that there is a serious issue of misleading investors here. "The danger is that this has a negative knock on effect to the private infrastructure market."

This is the biggest worry for me, because if the base market gets impacted who knows what could happen.

About the Author

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Rebecca Hampson is a finance and business journalist who has spent much of her career flirting with ETFs. She has written about many sectors across various online and print publications including Financial News, Citywire, Energy Risk, Structure Products Magazine, ETF Strategy and ETF.com.

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