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Opinion

Listed infrastructure investment is a great story, but it is a fake

VIEWPOINT

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For the past 15 years infrastructure investment has been the preserve of large sophisticated investors. It is rapidly becoming more mainstream, and asset owners of all sizes are considering investing in it.

Originally confined to private equity or debt strategies, the label "infrastructure" can now be found on numerous financial products. We argue that not all products labelled as such are adding value to the portfolio of an institutional investor.

In particular, the fast-growing listed infrastructure sector is shown by peer-reviewed academic research to offer zero additional value to an institutional portfolio.

We call this fake infrastructure.

Listed infrastructure is often presented as an investment that can do everything, from delivering a high Sharpe ratio, a measure of risk-adjusted returns, to hedging inflation, diversifying portfolio risk and protecting against market downturns — as well as being liquid, transparent and with a documented record.

It's a great story. Listed infrastructure products have mushroomed on the back of the newfound interest in infrastructure investment among medium to small investors. In 2006, there were nine listed infrastructure mutual funds and no listed infrastructure exchange traded funds. Ten years later, there are 66 listed infrastructure mutual funds and 32 ETFs tracking listed infrastructure indices.

In 2017, 17 index providers publish more than 25 listed infrastructure indices. Combining all mutual funds and ETFs referring to listed infrastructure, we tallied more than $50bn of assets under management allocated to these strategies at the end of 2016.

But listed infrastructure is a fake. It is not an asset class and does not capture the characteristics of private infrastructure investment.

Our research shows that listed infrastructure equity does not have a better risk-adjusted performance profile than the market index; does not exhibit downside protection characteristics; does not improve portfolio diversification; is replicable using traditional asset classes; and is also replicable using standard risk factors.

Listed infrastructure products should be understood from a portfolio-management perspective. Listed infrastructure funds are essentially active equity funds. The only difference from other active equity products is their focus on certain industrial sectors. One might say that they promise sector-specific alpha or above-benchmark returns.

Of course, decades of academic research has shown that alpha is mostly an optical illusion: it is mostly betas in disguise — in other words performance generated by wider market movements — that could be bought more cheaply than through active managers.

So listed infrastructure managers are just repackaging a product from the 1980s for the 2017 crowd.

Listed infrastructure ETFs, on the contrary, are a 21st century product: if the listed infrastructure asset class can improve portfolio diversification, lower portfolio volatility and has liability-hedging properties, could tracking an index of infrastructure stocks deliver new betas?

There are two important flaws in this idea. First, the listed infrastructure indices being tracked by ETFs are often built to include active views or using ad hoc weighting schemes, such as those that avoid over-concentration in a few very large utilities. It is not necessarily clear what systematic risk exposures are being tracked through these indices.

The second flaw is that these listed infrastructure indices do not have any asset class or unique-factor characteristics, such as low volatility or momentum, that typically reward institutional investors over the long term. This is why listed infrastructure is fake.

9 Number of listed infrastructure mutual funds in 2006

66 Number of listed infrastructure mutual funds in 2016

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