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INFRASTRUCTURE INVESTOR

Fake infra? They beg to differ

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While some may be prepared to dismiss the nascent listed infrastructure market, three top investors gather to tell Zak Bentley about the success of this disputed asset class and how it can grow in tandem with the unlisted side of the industry

In the days preceding our roundtable on listed infrastructure, a timely article appeared on the pages of the Financial Times branding the asset class “a fake”. It was written by those at the EDHECinfra institute, in Singapore, reinforcing the argument they produced in a report a few months ago. The original report even promulgated #fakeInfra in a Donald Trump-inspired promotion of its work.

While the social media campaign did not quite catch on, EDHECinfra maintained it could find “little to no robust evidence of a listed infrastructure asset class” separated from the general equities market and that “the listed infrastructure asset class does not exist”.

Far be it from me to question almost the very professional existence of those in the room, but it was hard not to start our annual listed infrastructure roundtable by asking our participants what they thought of EDHECinfra’s findings.

“Our observations are very different from their findings,” James Crutcher, senior analyst at CBRE Clarion, demurs. “We define what we call the ‘inclusive universe of infrastructure assets in the listed space’ and we find that over the long-term – 20 years – that does exhibit a lower volatility return than general equities. It’s also actually produced a higher return than general equities over that 20-year period.”

It is a view shared by AMP Capital’s Giuseppe Corona, who heads the firm’s global listed infrastructure division and believes the report failed to pick up on the time horizons typically associated with infrastructure investment. “If you don’t define time horizons, it’s worthless to discuss concepts such as risk, volatility and drawdowns,” he says. “Of course, if you shrink time horizon, the correlation, the drawdowns and the value of risk would be more tied to the general equity markets as we’re investing in listed vehicles. Regarding the correlation aspect, infrastructure by definition is a well-diversified asset class, thus it is reasonable to expect that the covariance of infrastructure sectors could be higher than within other asset classes.”

Ross Blakers, head of investment solutions group at Whitehelm Capital, concurs with this outlook and says what is defined as “true core infrastructure” has “clearly different fundamental drivers” from the mainstream equities the paper compares them with. He also believes the report failed to look at the infrastructure asset class as the relatively immature investment it is.

“The point I’d make on time horizon is that listed infrastructure is a really young asset class – as is unlisted – when compared with many of the traditional asset classes,” he asserts. “If your analysis is being heavily skewed by data that only has 20 years in terms of a solid data set and this is brought back to 10 years, can you draw meaningful conclusions from that? Given the past decade has now been dominated by central banks’ activity in financial markets, what conclusions could you draw about the future and how the asset class may perform in different market cycles? That’s where I struggle when that’s implied from this research.”

PUBLIC VS PRIVATE

Somewhat predictably, our participants are not exactly nodding in agreement with EDHECinfra’s conclusions. On the contrary, they are keen to stress the benefits of listed infrastructure investment, including the aspect of portfolio diversification that the Singaporean institute says offers nothing different from that of private infrastructure investment.

“The diversification of listed infrastructure can be very real depending on the investor’s starting point,” Blakers maintains. “Sure, unlisted infrastructure will always look superior on the portfolio-diversification front. However, many investors won’t have the resources, time, investment governance or skills to go and try to build a portfolio of 20 or 30 assets around the world. That takes a long time and a very specific skill set.”

Crutcher says this diversification is enabled by the liquidity aspect from which listed infrastructure benefits, in contrast to its private market counterpart. “[Liquidity] allows you to diversify,” he argues. “You need a huge amount of money to globally diversify yourself in the direct market the way you can with a smaller amount of capital in the listed market.”

Part of this comes from the growing levels of capital needed for assets in the private market. Investors are increasingly concerned about the high prices being paid for some – cutting into returns and available portfolio improvement and leading to a “haves” and “have-yachts” situation in the era of mega-funds and lower returns. “At the moment, if we look at large trophy assets in core infrastructure on the private side, a lot of those multiples are incredibly expensive, roughly double that of the listed side,” Blakers explains. “That’s a large premium to pay for diversification benefits.”

Crutcher agrees, but finds the trend is not particularly new, it just seems to be growing further now. “I think there’s always probably been a bit of a differential in pricing to listed and non-listed, but it looks wider at the moment than we have seen for a long time,” he says. “It strikes me that kind of opportunity doesn’t hang around for very long, though, and that is something that the general equity markets will pick up on sooner or later.”

One consequence of this situation is incursions by some of the large unlisted funds into the listed space, including Global Infrastructure Partners buying into Spain’s Gas Natural Fenosa last year, while more recently, IFM’s Global Infrastructure Fund has made a move to buy and de-list Mexican concession company OHL Concesiones. In its Q2 2017 review, CBRE said the public market continues to discount toll

road asset values and that it expects this type of activity to continue, while Corona says such a situation is "definitely a good evolution" of the listed market if it is bringing in different buyers for the asset class.

"We'll probably see more public-to-private transactions," Blakers predicts. "We'll see the unlisted funds that have raised a lot of money probably try to come and take some of the listed assets private. I think it's important that listed markets also provide opportunities where vendors can sell private assets into the listed markets. One of the areas where we're seeing this sector develop is in how asset owners are using the listed market alongside private markets. A framework offered whereby investors are able to move between the two depending on client-specific requirements and underlying valuations has tremendous appeal. And right now, I'd say we've got quite extreme conditions, which gives rise to these opportunities."

SHOCK RESISTANT

Obviously, it's not just in the financial markets where conditions are considered to be extreme. The world is currently getting to grips with unprecedented macro settings as it continues to assess how the fallouts of Brexit and Trump will materialise. However, Corona believes these developments should not be seen by the listed market as impending gloom.

"Sometimes these shocks to the system can be an opportunity, because of the price-value dislocation they often provide. If I look back on the past three years, some shocks have impacted our investment universe, such as the oil price decline in 2015-16 and the implication on the energy infrastructure sector in the US; Brexit and the related European political uncertainty; and the interest rate impact of the Trump election – these three times have actually been an opportunity to invest additional resources into the asset class because, clearly, in the short term, the equity markets overshoot the impact of these drivers."

However, while specialist investors such as our participants may be better positioned to turn such events into opportunities, Crutcher warns listed infrastructure fund managers against becoming political pundits.

"It's important at those points of opportunity to make sure you're not just underwriting a political outcome, which you may feel you have an edge on but really isn't your specialism, it's important at those points of opportunity that you are underwriting infrastructure valuation and the risk you're a specialist in, rather than taking essentially a bet on a political outcome."

Blakers believes investors need to see beyond a current environment and instead view the asset for what it truly is. "I think anything that's listed, anything that can be traded quickly with volume, there's going to be pros and cons to that," he maintains. "I think a lot of people struggle with it because of the concept of core infrastructure being long-term investments and those stereotypical attributes of stable, long-dated and inflation-linked cashflows. Then there's the market beta that sits on top that will give this asset class volatility and, at times, this could be quite a lot of market volatility. However, if you truly focus on the underlying characteristics of those businesses and you can look through the noise of the market beta, then you've got something that's really powerful and really attractive."

Speaking of cutting through noise, while Trump continues to fight fires in the White House and struggle with a legislative agenda in Congress, the President remains committed to a $1 trillion infrastructure plan. Yet our participants will not be acting with any haste based on his promises.

"There's a lot of positive soundbites about infrastructure but until we see a bit more substance, I think it's

hard to point to anything in our portfolio that would represent a tilt because of Donald Trump," Crutcher says.

Corona agrees, although he is monitoring the President's support for the pipelines that stuttered during President Obama's tenure. "Our investment process is based on bottom-up valuation so we'd never tilt our portfolio depending on what Trump decides or does not decide to do," Corona maintains. "Trump has been quite vocal in asking for the approval of some oil and gas pipelines and should those pipelines start to be built according to plans, that's something that could eventually impact our portfolio because it will impact the valuations that we have on these assets that right now are not included in our valuation."

Trump's infrastructure ambitions should encounter little resistance, Blakers hopes – but he also remains reserved on the issue. "I think in terms of what it means down the track, it's still a forward-looking thing. It wasn't a tweet and overnight we had another 100 companies to invest in that were available. That said, existing assets did reprice quite quickly following Trump's winning of the presidency."

GROWING PAINS

For a relatively young asset class, the listed infrastructure market has achieved some impressive growth. Corona points to the close to $2.8 trillion invested in listed infrastructure globally, compared with about $2 trillion five years ago, while he estimates there are now around 300 companies in the listed infrastructure investment universe. "The funds under management that we oversee have increased quite significantly," he adds. "Clearly the growth is there and we don't expect this trend to change any time soon."

Crutcher agrees yet believes the money invested in listed infrastructure still represents a "drop in the ocean" when compared with listed real estate. On reflection, he feels listed infrastructure is in a state where its real estate counterpart sat around 15 years ago. "There were specialist managers but they didn't dominate the space," he explains.

"Maybe as an investor looking to add relative performance, perhaps we don't want it to mature any further than it is," he quips. "It feels like it's still at a relative immaturity in that sense and opportunities come with that."

Blakers shares this view and sees the investment community still trying to get to grips with listed infrastructure and what it can add to a portfolio. "Institutional investors are in the early stages of really understanding and appreciating what this asset class is. That evolution is in its early days and where this ends up is quite interesting."

Why does this still remain the situation? "I think the consultant community, for one reason or another in Europe and particularly in the UK, is more averse to getting their real asset exposure through the listed market. Certainly less so than on the Continent and far less so than in Australia – and then the US is somewhere in between," Crutcher assesses. He adds that the building blocks are present for the listed market to grow beyond this state, although concedes the difficulties of comparing listed and unlisted infrastructure returns are going to be something that holds back certain investors.

The EDHECinfra paper that our participants contest accuses managers of presenting listed infrastructure as a silver bullet that can deliver all the great benefits of liquidity, diversification and market protection – but while Corona hails the "tremendous growth" experienced and Crutcher describes a "very healthy and functioning investment space", they remain under no illusions.

“I think we’re just at the early stages of still seeing where this goes,” Blakers says. “It’s still a very young asset class when you compare it with most others, so there’s a huge opportunity out there in front of us and for asset owners. Seeing the investment universe grow so we can build an even more diversified portfolio would be a lovely thing.”

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