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What Is Global Listed Infrastructure?

By Susan Dambekaln

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As the coronavirus pandemic drives governments to Keynesian economics, infrastructure spending is set for a huge increase, with attention focused on sustainable development goals. Sustainable global listed infrastructure will help address critical financing issues, as a complement to private-market infrastructure, and will provide investors unique attributes that contribute to an investment portfolio's diversification and income needs.

Infrastructure assets usually are built to have long useful lives because they provide a vital service and are expensive to construct. Additionally, the demand for the output from these assets tends to be inelastic given the scarcity of the resource being offered.

WHAT IS GLOBAL LISTED INFRASTRUCTURE?

Simply defined, infrastructure assets represent a broad mix of the large-scale public systems, services, and facilities of a country or region that are necessary for economic activity to function. Some examples of infrastructure include power generation and transmission, water supplies and wastewater treatment, public transportation, rail, roads, bridges, tunnels, ports, airports, telecommunications, and finally, basic social services such as schools and hospitals. The global listed infrastructure market represents a value of roughly $3.8 trillion of outstanding securities currently in the market.[1]

Infrastructure has emerged as its own differentiated asset class providing unique investment characteristics. Part of what defines infrastructure assets is that they provide necessary goods or services to society and they have monopolistic positions in their markets with high barriers to entry for competitors. Given these characteristics, infrastructure assets tend to be highly regulated, which results in investments with distinct qualities.

Infrastructure assets usually are built to have long useful lives because they provide a vital service and are expensive to construct. Additionally, the demand for the output from these assets tends to be inelastic given the scarcity of the resource being offered. With the pricing power that results from their position in the market, the revenue growth from these assets typically is limited by regulators to the rate of inflation. These factors result in infrastructure investments being able to offer long-term stable cash flows that have the potential for hedging inflation.

Another characteristic of infrastructure investments is that they exhibit a hybrid nature of fixed income cash flows coupled with capital gains. They behave somewhat like a bond with their stable cash flows described above. In addition, these assets can be improved upon and their capacity can be expanded allowing for their principal value to grow over time. The best opportunity for capital gains comes from investments involving development risk or monopoly businesses.

Finally, infrastructure investments offer a variety of risk and return profiles. Infrastructure investments range from low-risk regulated assets to moderate-risk loosely regulated entities such as energy production. The assets offer varying amounts of inflation protection and different levels of vulnerability to economic cycles. It is important to note that although these assets are all considered the same asset class, not all of them will exhibit the same risk and return behavior.

WHAT IS THE INFRASTRUCTURE OPPORTUNITY?

Global demographic trends are driving the need for infrastructure construction in the world's developing economies. China and India have shifted from agrarian to industrial and urban societies. These countries require new, modern infrastructure to facilitate the expansion of industry, the urbanization of their economies, and the effects of continued population growth and an expanding middle class.

In the developed markets, the basic infrastructure is worn and dilapidated, having been constructed in the middle of the twentieth century. In most developed economies, the percent of gross domestic product (GDP) that is spent on infrastructure has been declining steadily for decades, leaving a crumbling legacy. This entire supply of old infrastructure needs to be either repaired or replaced.

The Organisation for Economic Co-operation and Development projects the level of investment needed to meet growing worldwide infrastructure demand will equal 3.5 percent of world GDP through the year 2030, or more than US$55 trillion. The areas in most need of investment are development and modernization of roads, power networks, water systems, and telecommunication networks.

The amount of investment that is required to fix or upgrade existing infrastructure in the developed economies is truly stunning, especially when one examines the state of infrastructure in the United States. The American Society of Civil Engineers has estimated that U.S. infrastructure funding needs are $5.937 trillion over a 10-year period from 2020 to 2029.[2]

Even more disconcerting, funding levels as a share of all federal expenditures are exactly the same as they were more than 20 years ago. The United States' crumbling infrastructure has been well documented over the past few years (see table 1). The ready supply of capital for projects is dwarfed by the demand for infrastructure, which is driven by the following:

- Population growth
- Urbanization
- Aging infrastructure
- Favorable economic and political climates

Over the years, the U.S. government has pushed the responsibility for the growth and upkeep of infrastructure down to the state level. The states have found that they have been unable to meet the capital requirements of this task. Real estate taxes, income taxes, and sales taxes all have declined precisely when the need for capital is the greatest. With the states' inability to incur a budget deficit from year to year, they are unable to generate the capital for essential improvements to their infrastructure. The states are at a crossroads and many are now beginning to court private investors to fill their budget gaps.

The recent commitment to building the country's future through stimulus efforts in infrastructure spending and project development will provide a much-needed lift to job creation through sustainable infrastructure development. In addition to the long-term trends that are benefitting infrastructure, the 2021 stimulus package by the U.S. government will benefit this sector directly and help achieve numerous long-term environmental, social, and governance (ESG) policy goals (see table 2).

Investors are viewing global listed infrastructure as a unique portfolio management tool offering alternative access to a dynamic market opportunity. The liquidity and transparency have become more attractive than ever in today's opaque

Table 1

REPORT CARD FOR AMERICA'S INFRASTRUCTURE

America's Infrastructure currently holds a 'C–' Average

Aviation	D+	Ports	B–
Bridges	C	Public Parks and Recreation	D+
Dams	D	Rail	B
Drinking Water	C–	Roads	D
Energy	C–	School	D+
Hazardous Waste	D+	Solid Waste	C+
Inland Waterways	D+	Transit	D–
Levees	D	Wastewater	D+

Source: American Society of Civil Engineers, 2021 Report Card for America's Infrastructure

Table 2

BIDEN ADMINISTRATION ESG POLICY ACTIONS IN FIRST 100 DAYS IN OFFICE

ESG Policy Area	Biden's Policy Action in First 100 Days in Office	ESG Theme
Carbon Neutrality	Immediate commitment to net-zero emissions by 2050 or earlier, with interim details subject to international diplomacy (namely China's decarbonization plan)	• Low Carbon
Power Generation	100-percent carbon pollution-free electricity by 2035 with new clean water/air standards and steps to reduce methane emissions	• Clean Energy • Clean Water
Transportation	By 2030, all new light- and medium-duty vehicles sold are zero emission, U.S.-built buses are zero emission, and 500,000 EV charging stations are built (currently c. 120,000)	• Clean Tech EVs/Batteries
Construction	Establish an Energy Efficiency and Clean Electricity Standard to upgrade 4 million buildings and weatherize 2 million homes over four years	• Green Building Infrastructure
Innovation	Create a new Advanced Research Project Agency for Climate (ARPA-C) to support new low-carbon tech	• Carbon Tech
Oil and Gas	Plug abandoned oil and natural gas wells and reclaim abandoned mines—possibility that they announce a new CCUS plan to fill abandoned wells with captured carbon	• Clean Energy • Energy Storage
Agriculture	Make U.S. agricultural industry first to reach net-zero emissions globally	• Low Carbon

Source: Capital Innovations, Axios, Vanda, Politico, Bloomberg (January 2021); CCUS = carbon capture, utilization, and sequestration investment environment. The ability to generate income and total return explains some of its recent gain in popularity, particularly in light of bond yield compression and stock performance concentrated in a select number of technology stock darlings.

BENEFITS OF GLOBAL LISTED INFRASTRUCTURE INVESTMENTS

In a recent 2020 BlackRock survey,[3] investors listed the following as their top attributes of an attractive investment:

- Diversification
- Liquidity
- Reasonable fees
- Valuation and daily market pricing
- Transparent corporate governance
- Active management and value creation

Global listed infrastructure can provide these unique attributes to investors in a framework that can be straightforward and easy to understand, differentiating it from many other complex, unlisted (private equity–type) investments.

Diversification. There are a series of risk and return elements to any investment strategy. Listed infrastructure permits investors to diversify across sectors, which may help to ameliorate some of the inherent risks that are present in infrastructure. These risks include regulatory risk, demand risk, interest-rate risk, and refinancing risk. Diversification across regulatory sectors, physical assets, currency exposure, and political risks (country or region) helps an investor construct a portfolio that achieves the desired risk return profile or risk budgeting process. This can be achieved in a global diversified portfolio of holdings.

An actively managed portfolio of global listed infrastructure investments at institutional pricing can be more attractive than buying the benchmark and paying active management fees in a passive product or exchange-traded fund (ETF).

Large investment universe that provides liquidity. Investors may access investment vehicles, separately managed accounts, and mutual funds, all of which have liquidity that is not available in direct project finance deals. The current global listed infrastructure universe capitalization is approximately $3.8 trillion.[4] This liquidity feature easily allows investors to put money to work and to adjust the global listed infrastructure exposure in their dynamic asset allocation models.

Table 3

INFRASTRUCTURE STOCKS PROVIDE RETURN ENHANCEMENT TO STOCK AND BOND PORTFOLIOS

	Bonds	Stocks	Infrastructure
Returns*	3.19%	12.26%	7.43%
Volatility	2.89%	18.38%	11.99%
Correlation	–0.1	–0.1	1.0

Returns: five-year compound annual returns through December 31, 2020

Volatility: five-year through December 31, 2020

Infrastructure correlation: 2008–2020 (JPMorgan)

Bonds: Bloomberg Barclays Global Aggregate Bond Index

Stocks: MSCI AC World Index

Infrastructure: MSCI Global Infrastructure Index

**The MSCI World Infrastructure Index captures the global opportunity set of companies that are owners or operators of infrastructure assets. Constituents are selected from the equity universe of MSCI World, the parent index, which covers mid and large cap securities across the 23 Developed Markets (DM) countries. All index constituents are categorized in one of thirteen sub-industries according to the Global Industry Classification Standard (GICS®), which MSCI then aggregates and groups into five infrastructure sectors: Telecommunications, Utilities, Energy, Transportation, and Social.*

Reasonable fees. "Fee drag" or the fees that are assessed to an investment portfolio challenge investors and portfolio managers alike when it comes to investment performance. Fees are typically higher in private infrastructure transactions and private-market vehicles. An actively managed portfolio of global listed infrastructure investments at institutional pricing can be more attractive than buying the benchmark and paying active management fees in a passive product or exchange-traded fund (ETF).

Valuation and daily market pricing. Unlisted infrastructure valuations are performed by an independent auditor or administrator. On the other hand, because listed securities are exchange traded and market priced, investors are provided with the transparency that they need, especially in the current market environment where investment transparency is at a premium.

Transparent governance. Listed companies are subject to media scrutiny and examination by regulatory authorities, governments, labor unions, and investor advocacy groups such as the United Nations Principles for Responsible Investment and the United Nations Global Compact. There is increased focus by listed companies on ESG.

Active management. The value proposition behind active investments in a portfolio of global listed infrastructure securities can be seen through examining the composition of the frequently used benchmarks. The FTSE Global Core Infrastructure 50/50 Benchmark adheres to an industry-defined interpretation of infrastructure with 50 percent in utilities companies, 30 percent in transportation companies, and 20 percent in other sectors. The S&P Global Infrastructure Index has 40 percent of its listings in utilities companies, 40 percent in transportation companies, and 20 percent in energy companies. Active portfolio management in the global listed infrastructure sector provides the ability to generate significant returns while avoiding unwanted sector concentration in the benchmark. Additionally, stock market volatility has risen, creating a greater dispersion of returns among individual stocks and expanding the scope for active managers to distinguish themselves from a benchmark.

RISKS AND REWARDS

Investing in global listed infrastructure provides the ability for investors to add income, further diversify their portfolios, and improve overall long-term performance. Investors add another asset class with a low degree of correlation to the aggregate portfolio. If history is an indicator, stock market recoveries have come in relatively short bursts and outperformance has occurred in a select number of sectors; infrastructure has been one of these sectors. As the markets continue to rebound from their lows, listed infrastructure is well positioned to capitalize for investors.

The historical data shows that infrastructure stocks typically have yielded 5.15 percent while traditional stocks have returned 4.37 percent and bonds have produced 4.29 percent (see figure 1).

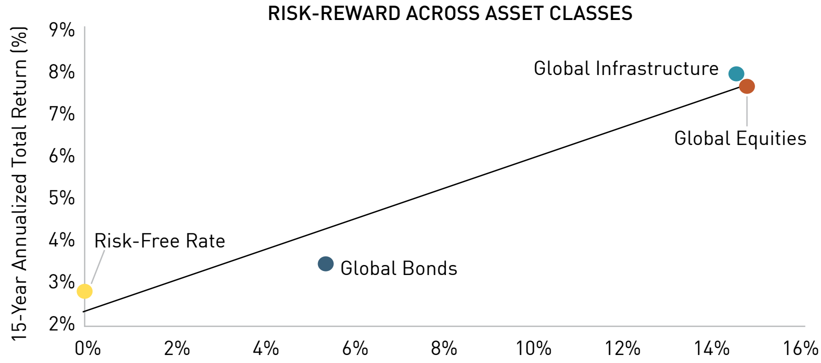
Yield and growth potential have made infrastructure stocks attractive during economic booms and busts, particularly when compared with the long-term performance characteristics of common stocks and bonds (see figure 2 and table 3).

INVESTMENT OUTLOOK

Global growth dynamics continue to drive investment in infrastructure worldwide (see figure 3). Population regions in Latin America, China, and India are experiencing infrastructure investment growth over multiple sectors including regulated utilities, transportation, and social infrastructure. This infrastructure investment growth is necessary for these regions to accommodate their burgeoning populations.

Figure 1

INFRASTRUCTURE HAS OFFERED STRONG RISK-ADJUSTED RETURNS RELATIVE TO OTHER ASSET CLASSES OVER TIME

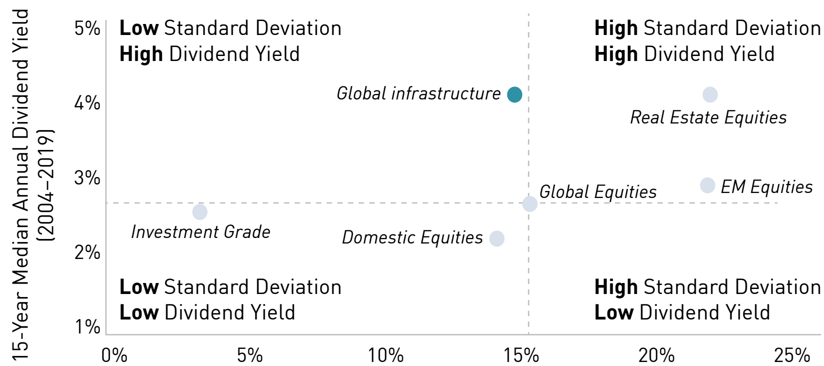


Source: Bloomberg as of September 30, 2020

Global Bonds: Bloomberg Barclays Global Agg; Global Equities: MSCI All Country World; Infrastructure: S&P Global Infrastructure. For institutional use only.

Figure 2

INFRASTRUCTURE HAS OFFERED AN ATTRACTIVE SUSTAINABLE YIELD



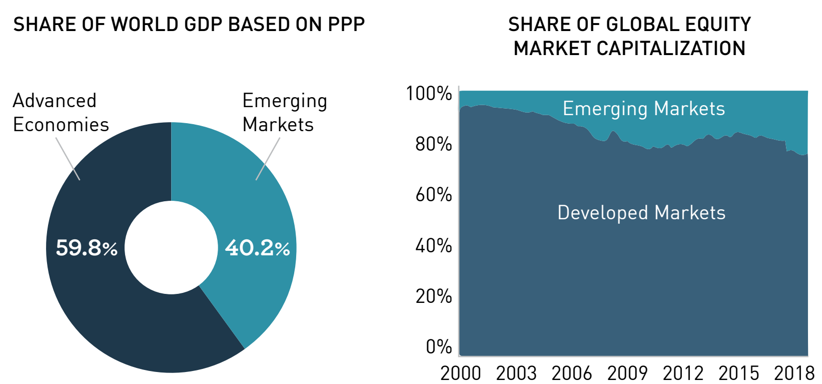
Infrastructure has provided a high-income yield for investors relative to other asset classes with lower risk than most other equity asset classes

Source: Bloomberg, FactSet as of September 30, 2020.

Domestic Equities: S&P 500; Global Equities: MSCI All Country World; Emerging Markets: MSCI EM; Real Estate: DJ US Real Estate; Infrastructure: S&P Global Infrastructure; Investment Grade: Barclays US Agg. Bond. For institutional use only.

Figure 3

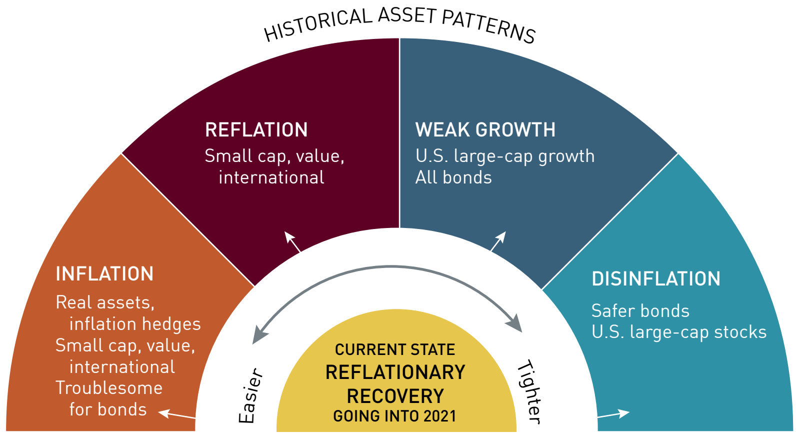
EMERGING MARKETS SHARE OF GLOBAL GDP IS NOW 60% BUT MAKES UP JUST 23% OF THE GLOBAL EQUITY MARKET CAP



Source: International Monetary Fund (left); Bloomberg (right)

Figure 4

REFLATIONARY RECOVERY GOING INTO 2021



Source: Fidelity Investments First Quarter 2021 Quarterly Market Update

POLICY AND INFLATION DIRECTION CRITICAL TO 2021 OUTLOOK

Markets entered 2021 with a reflationary recovery dynamic (see figure 4). As economic reopening occurs, patterns may be influenced by the trajectories of policy, inflation, and real interest rates. More accommodative monetary and fiscal policies could generate inflationary pressure, whereas a move toward policy normalization could result in a growth disappointment. We expect the potential for elevated volatility in 2021.

On the horizon is the potential for asset sales from governments to help balance their increased financing strategies.

From an economic perspective, there are concerns regarding short-term deflation and widespread fears of long-term, worldwide inflation. Coronavirus stimulus packages have injected trillions of additional dollars into the U.S. financial system, leading investors to the next big challenge: a rising inflationary environment. Many members of Wall Street's old guard witnessed this type of environment in the 1970s.

In hopes of staving off the effects of transitory deflation and the subsequent accelerating inflationary regime, investors have begun to pile into bonds, real estate, and infrastructure. Investors now are faced with a common predicament: how to position themselves for the next investment cycle.

INFRASTRUCTURE OUTLOOK: KEY THEMES DRIVING 2021 OPPORTUNITIES

Interest rates. We continue to believe a lower-for-longer theme exists and helps boost valuation in the infrastructure sector along with increasing the attractiveness of cash-generative assets. On a long-term basis, we remain focused on inflationary pressures.

Allocations. We continue to expect increased asset allocation to the infrastructure sector from pension funds and sovereign wealth funds among other investors given the risk-adjusted returns available compared to the returns available in fixed income and securities markets.

Government actions. During the pandemic, a considerable amount of stimulus has been injected into a number of economies in the world. In some jurisdictions, stimulus was directed toward a variety of infrastructure programs to aid economic recovery and broader-based economic multipliers. On the horizon is the potential for asset sales from governments to help balance their increased financing strategies.

Transport volumes. Transportation infrastructure ranges from meaningful recovery trades with transit systems and toll roads to comparatively less volumetric growth from rails and ports.

Ramped-up renewables. Across the globe, there is a significant focus on renewable generation growth and energy transition. In many cases, the valuations of renewable stocks embed a good portion of value for development pipelines. Some renewable opportunities exist on a value basis with portfolios invested in stocks undergoing significant energy transitions.

Airports. Airports with a greater focus on low-cost carriers look to be better positioned for recovery trades versus airports focused on business travel.

Carbon and hydrogen. The price of carbon remains in focus and the continued efforts toward widespread hydrogen utilization are major restructuring themes.

Data focus. The 5G and data infrastructure trends remain robust across the globe and tend to offer greater than traditional infrastructure growth rates.

Natural networks. Larger scale network owners (electricity, gas, hydrocarbons, etc.) and North American energy infrastructure owners facilitating exports from the continent (across all hydrocarbons) are well positioned for ongoing growth given changing supply-demand patterns. The performance dichotomy between electric and natural gas utilities will provide selected investment opportunities on a longer-term basis.

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GLOBAL LISTED INFRASTRUCTURE

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CONCLUSION

The bottom line is that after an enormous run-up in renewables, hydrogen, and related fields, the time may be right to focus on other elements of ESG and the broader green agenda that could rise quickly in 2021 around the economics and politics of climate change. One immediate test will be to look at the composition of the next COVID-19-related stimulus package from the Biden administration—expect it to be packed with green jobs-related spending to jumpstart this new agenda.

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ENDNOTES

1. S&P Global Listed Infrastructure Assets—A Primer 2020, https://www.spglobal.com/_assets/documents/ratings/research/infrastructure-finance-outlook-issue-1-2020.pdf.
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4. S&P Global Thematic Indices Report 2020, https://www.spglobal.com/spdji/en/documents/methodologies/methodology-sp-thematic-indices.pdf.

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