Global Listed Infrastructure

Monthly Review and Outlook

April 2016

Key highlights:

- The Fund consolidated recent strong returns with another 1.5% in April, 60 bps ahead of its benchmark index
- Pipelines, railroads and toll roads gained following positive earnings result, while ports and utilities lagged
- Latin America continued to rally from January lows; Japan was impacted by news of deflation

Market review

Global listed infrastructure built on first quarter gains as company earnings numbers highlighted infrastructure's stable, cash generative characteristics. In SGD terms (total return), the FTSE Global Core Infrastructure 50-50 index rose 0.9%; global equities ended the month 1.5% higher.

The best performing sector was **Pipeli nes** which rallied on higher oil prices and evidence that companies within the sector are beginning to repair overstretched balance sheets through capex cuts and lower distribution growth. **Water utilities** gained on strengthening LatAm names, and demand for the highly visible cash flows and regulated real returns offered by US and UK peers. Ports (-3%) and electric/gas Utilities (-2%) took a breather after recent strong performances.

The best performing region was Latin America. Gains were led by Brazilian infrastructure stocks, on rising hopes of political change following the increasingly likely impeachment of incumbent President Dilma Rousseff. However infrastructure in **Japan** fell after the Bank of Japan unexpectedly refrained from expanding its QE program, despite worsening business sentiment and news the country had fallen into deflation for the first time since 2013.

Fund review

In SGD terms, the Fund returned 1.5% in April, 60 bps ahead of its benchmark index.

The best performing stock in the portfolio was Brazil's largest toll road operator **CCR**, which surged on resilient traffic volumes and the prospect of a less bad macroeconomic backdrop. São Paulo water utility **SABESP** extended its rally; an 8% tariff increase provided further evidence of a constructive regulatory approach, while water levels at its reservoirs continued to improve.

Underlying LatAm exposure buoyed the performance of several other portfolio holdings. US-listed freight rail operator **Kansas City Southern**, which derives ~50% of its earnings from Mexican operations, gained on 1Q results which were bolstered by solid core pricing and impressive cost control. Spanish-listed **Abertis**, whose portfolio of mature toll road concessions includes significant assets in Brazil and Chile, announced pleasing 1Q traffic numbers. An 18% yoy increase in March passenger numbers for Mexican airport operator **GAP** drove better than expected 1Q earnings numbers.

Gains in Europe were led by transport infrastructure. **Eurotunnel** announced 1Q earnings that included firm pricing, record traffic volumes and a 4% increase in revenue. The opening of routes to new destinations such as Amsterdam in 2017 represents additional earnings growth potential. **AENA**, which operates Spain's major airports, saw an uplift in volumes as tourists opted for European holiday destinations over Turkey or North Africa due to security concerns.

The Fund's US railroads and pipelines also rose. As well as Kansas City Southern, west coast freight rail operator **Union Pacific** and eastern peer **CSX** gained as surprisingly robust 1Q results indicated that although coal volumes continue to fall, productivity measures are helping to offset weak volumes and core pricing remains strong. Pipeline operators **Magellan Midstream Partners**, **Enbridge Inc** and **Columbia Pipeline Group** climbed as a higher oil price supported interest in the sector.

The worst performing stock was **COSCO Pacific**, which underperformed after quarterly results disappointed due to higher than expected costs associated with corporate restructuring and M&A activity. Hong Kong-listed electric utility **Power Assets Holdings** also fell after acquiring a 49% stake in the Canadian midstream assets of Husky Energy for almost US$1 billion. The connected transaction reduces the large cash holding on PAH's balance sheet, dimming hopes of a large special dividend to shareholders.

The other main detractors from Fund performance were regulated utilities such as **Xcel Energy**, **Alliant Energy** and Eversource Energy (-3%). Rising bond yields saw the market's focus switch to more cyclical stocks, causing this defensive, income-focused segment of the market to lag.

The Fund took advantage of this dip to broaden its utilities exposure, buying shares in **Iberdrola**, **El Paso Electric** and **United Utilities**. Spanish-listed electric utility Iberdrola owns power plants and energy transmission networks in the US, UK, Latin America and Spain, including substantial renewable energy assets. Political stalemate in Spain and the forthcoming Brexit vote have weighed on its share price, causing the stock to move higher within our investment process. Potential catalysts for outperformance from here include low risk earnings growth derived from renewables and transmission buildout; and greater political certainty in its countries of operation as the year progresses.

El Paso Electric is a $1.5 billion market cap, fully regulated electric utility which operates in west Texas and southern New Mexico and trades at an appealing valuation. The company is replacing coal with gas-fired generation assets, putting it in a favourable position given the current US legislative focus on low-emission power generation. Demand for energy within its service area is expected to grow consistently in coming years; and its size and location make it a potential takeover target.

United Utilities, the UK's largest listed water company, provides essential water and sewerage services to around seven million people in North West England. Allowed earnings are set by a regulator over five year periods and linked to inflation, giving the company a very predictable earnings profile and the ability to provide steady real returns within each regulatory cycle. Operational improvements and efficiency gains have the potential to deliver additional earnings growth. The stock is supported by a dividend yield of over 4%.

Outlook

The Fund invests in a wide range of global listed infrastructure assets including toll roads, airports, ports, railroads, utilities, pipelines and mobile towers. These sectors share common characteristics, like barriers to entry and pricing power, which can provide investors with inflation-protected income and strong capital growth over the medium-term.

We believe that toll roads, mobile towers and freight rail operators offer exceptional value. Toll roads have robust core franchises, are trading at attractive valuations and are paying well-backed dividend yields of between 4% and 6%. Mobile towers continue to benefit from structural growth in demand for mobile data, which is placing telecom companies under ongoing pressure to improve network quality and capacity.

US freight rail stocks have faced negative earnings revisions; however these high quality companies are trading at undemanding valuations. In our view, the market's focus on short term weakness has caused it to overlook the strength in core pricing, ongoing improvements in efficiency and the capacity and willingness to carry out share buy-backs across this sector.

Conversely the airports and satellites sectors look expensive on fundamental measures. For example, Asia-Pacific airports are trading on optimistic valuations driven by investor enthusiasm for recent rapid growth in Chinese passenger numbers, causing us to take a cautious approach towards these stocks.