First State Investments

Global Listed Infrastructure

Monthly Review and Outlook

October 2016

Key highlights:

- The Fund declined by -0.8% in October. Calendar YTD returns remain positive, at +10.6%.
- Ports were the best performing sector, supported by robust volumes; pipelines lagged on lacklustre earnings numbers.
- Latin America and Japan were the best performing regions. Oceania underperformed for a second consecutive month.

Market review

Global listed infrastructure declined in October against a backdrop of mixed quarterly earnings numbers, higher bond yields and political uncertainty ahead of the US Presidential election. In SGD terms, the FTSE Global Core Infrastructure 50-50 index and global equities both gained 0.1%.

The best performing sector was **Ports**, which gained on positive volume data. The next-best performing sectors were **Utilities** on the appeal of their defensive, low risk, capex driven earnings growth and stable dividend streams. **Towers** (flat) were supported by their lack of economic sensitivity, underpinned by structural growth in demand for mobile data.

Pipelines gave up ground as the sector's strong rally since early 2016 lost momentum on mixed quarterly earnings announcements and a lower oil price.

Latin America was the best performing region, led higher by Brazil's water and electric utilities. **Oceania** underperformed as Sydney Airport (-10%, not held) and Auckland Airport (-10%, not held) lagged on valuation concerns.

Fund review

In SGD terms, the Fund declined 0.8% in October, 70bps behind its benchmark index.

The best performing stock in the Fund was German airport **Fraport**, which rallied on the view that authorities may allow it to raise airport fees at Frankfurt Airport; and on hopes that a recently received US$270 million compensation payment from the Philippines government could be paid to investors as a special dividend. **Japan Airport Terminal** climbed on strong growth in international arrivals in September, particularly from China, at Haneda, Narita and Kansai airports. AENA also gained as capacity growth on Asian, US and UK routes supported volumes across its network of high quality Spanish airports.

The portfolio's utility holdings performed relatively well in an uncertain market environment. Larger UK and US names including **NextEra Energy, Eversource Energy, PG&E, SSE** and **Dominion Energy** held up. These companies continue to derive low risk earnings growth by investing in much-needed transmission infrastructure; and by participating in the accelerating shift towards renewable energy.

Smaller gas-focussed utilities including **Tokyo Gas, UGI Corp** and **Rubis** also gained. Tokyo Gas rallied on positive September volumes led by a 7% increase from its industrial segment, on higher gas demand for power generation. UGI Corp announced it expects 2016 earnings to be at the upper end of its guidance range, despite unusually warm weather in 2016 impacting demand. Normalised weather in 2017 could underpin further earnings growth.

The worst performing stock in the Fund was **Eurotunnel**, which fell on growing concerns that a 'hard Brexit' could affect demand for its unique, long concession life infrastructure asset. The positive impact of a 14% increase in truck volumes on its vehicle shuttle service in 3Q was partially offset by a surprising 10% fall in Eurostar passengers.

North American rail companies underperformed. **Union Pacific** fell post a poor 3Q result and concerns that lower freight volumes may be eroded its pricing power. Easier volume comparisons are likely to provide a tailwind in coming quarters. **Kansas City Southern** lagged on disappointing 3Q earnings, as flooding on its rail network in Louisiana pushed costs higher and weighed on volumes. Stable, low-risk. Japanese passenger rail operator East Japan Railway climbed after announcing 2Q earnings results in line with consensus.

Australian toll road operator **Transurban** also fell as September quarter earnings showed that traffic growth in its key market of Sydney declined to a lower-than-expected 3.5%.

Energy pipeline company **Kinder Morgan** lagged after a weak 3Q result and concerns that its current strategy of de-gearing and balance sheet repair may take longer to achieve than initially hoped. Elsewhere in the sector, Canadian peer **TransCanada** fared comparatively well as the market continued to digest the implications of its recent takeover of **Spectra Energy**. **Enbridge Inc (flat)** held up ahead of its 3Q earnings results, scheduled for early November.

The Fund added to its Pipelines exposure by initiating a position in **Enterprise Products Partners**, a US$57 billion market cap, high quality operator run by a well-regarded and experienced management team. Its assets include approximately 51,000 miles of pipelines and 200 million barrels of storage capacity. The company has a strong balance sheet, pays a distribution yield of ~6% and has a robust earnings growth profile based on exposure to US energy exports and growth in Natural Gas Liquids.

The Fund sold its shares in large cap US electric utility **Duke Energy** as positive returns during our extended holding period moved it lower within our investment process.

Our largest underweight position is in US utilities. Some companies in this sector face challenging regulatory environments; are trading at full valuation multiples; or derive a significant portion of their revenue from merchant coal generation, which now faces a vicious cycle of declining market share, reduced revenues and rising costs.

Our main holdings in this sector are made up of companies that are at the forefront of renewable build-out such as NextEra Energy and Xcel Energy; an area of the market that is experiencing a virtuous cycle of falling costs, improving productivity and growing market share. We also have exposure to companies which are participating in the build-out of much needed transmission infrastructure such as Eversource Energy and Dominion Resources.