Global Listed Infrastructure

Monthly Review and Outlook

November 2016

Key highlights:

- A challenging month for Listed Infrastructure as political change and a sharp rise in bond yields dampened returns. These two key risks for the sector are now better reflected in valuations, providing an attractive entry point for long-term investors.
- In SGD terms, The First State Listed Infrastructure (the "Fund") was relatively well positioned and outperformed by 240 basis points, gained 0.9% compared to a benchmark return of -1.5%.
- US freight rail and energy pipelines increased on the prospect of a more supportive legislative / regulatory environment and corporate tax cuts. Rising bond yields weighed on mobile towers and utilities. A weaker yen drove Japanese infrastructure stocks higher while the UK and Latin America underperformed.

Market review

Global listed infrastructure declined in November as financial markets absorbed the unexpected US Presidential election result. In SGD terms, the FTSE Global Core Infrastructure 50/50 index ended the month down 1.5% while global equities rose 4.5%.

The best performing infrastructure sector was **Railroads**, which rallied on hopes that a Trump presidency could lower corporate tax rates and stimulate economic activity. Policies that are more supportive of fossil fuels could slow the rate of decline of coal usage in the US and provide an additional tailwind for haulage volumes at a point when comparative periods are already getting easier.

Pipelines gained on hopes that Trump's leadership could lead to additional capital expenditure opportunities for the sector. Lower levels of regulation and greater support for US energy exports have the potential to both enlarge and significantly de-risk US energy infrastructure. An unexpected agreement by OPEC members to cut oil output for the first time in eight years also buoyed the sector.

Towers and **Utilities** gave up ground as rising bond yields dampened sentiment towards interest rate-sensitive investments.

Japan was the best performing region as yen weakness offered support to the country's ports, airports and passenger rail stocks. The **UK** underperformed due to its high utilities weighting. **Latin America** lagged after strong gains earlier in 2016, on uncertainty about the impact that a Trump administration could have on the region; and on a strengthening US dollar.

Fund review

In SGD terms, the Fund rose 0.9% in November, 240 bps ahead of its benchmark index.

The best performing stock in the Fund was Japanese port operator **Kamigumi**, which announced a larger than expected ¥5 billion (US$45 million) share buy-back. Hong Kong listed **Cosco Shipping Ports** recovered ground in November, following the announcement of disappointing third quarter earnings in the previous month. However **China Merchants Ports** lagged on a less clear outlook for global trade, despite achieving robust 5% organic container volume growth for the month of October. Lingering concerns about the company's strategic direction, following October's purchase of a residential property in Shenzhen, also weighed on the stock.

US freight rail operator **Union Pacific** climbed after announcing the renewal of its share buyback program and a 10% dividend increase; and on hopes of a more favourable operating environment. A more subdued gain by **Kansas City Southern**, whose rail network straddles the US/Mexico border, reflected a balance between positive sector fundamentals and uncertainty about future US-Mexican trade arrangements under Trump. Passenger rail operator **East Japan Railway** rallied along with the broader Japanese market.

US pipeline operators **Kinder Morgan** and E**nterprise Products Partners** rallied on hopes of a friendlier legislative environment. Kinder Morgan was also supported by approval from the Canadian Prime Minister for its Trans Mountain pipeline expansion; although local opposition to this project remains. The Fund's holdings in Canadian pipeline operators **TransCanada** and **Enbridge Inc** dipped as investors cycled into US peers.

The worst performing stock in the Fund was Brazil toll road **CCR**, which fell despite announcing better than expected third quarter earnings results, as investor appetite for Emerging Markets assets waned. The Fund's other Latin American holding, Mexican airport operator **GAP**, held up thanks to continued robust passenger growth, including a 19% year-over-year gain for the month of October.

Sentiment towards the mobile tower sector was dented by the view that a Trump administration could be more receptive to a merger between telecom operators Sprint and T-Mobile. As large customers of the towers, this could lead to revenue churn of between 4% and 8% as a potential combined entity streamlines its network. With multiple years remaining on the contracts and any potential merger far from certain (or even announced) we suspect the market view could be too pessimistic.

Rising US 10 year Treasury yields impacted a broad range of utilities as investors came to terms with a higher interest rate environment. The UK's **National Grid** and **SSE**; US operators **NextEra Energy**, **Eversource Energy** and **Xcel Energy**; and Spanish-listed **Iberdrola** underperformed. The Fund's Asian utility holdings held up better. **Tokyo Gas** was supported by its modest valuation multiple and strong October natural gas sales, driven by higher demand from commercial and industrial customers. Hong Kong-listed **Power Assets Holdings** outperformed thanks to its cash-rich balance sheet.

The Fund bought shares in **Aeroports de Paris**, which operates Charles de Gaulle and Orly airports, and also owns minority stakes in Dutch, Turkish and Chilean airports. This high quality company currently trades at a modest valuation multiple which does not reflect the earnings growth potential from expected Air France capacity additions; improving passenger numbers on Asian routes; and recovering passenger numbers in Turkey.

Holdings in East Coast-focused US freight rail stock **CSX** were sold as its share price approached all-time highs. The positive outlook for the stock appears to be fully priced in, following its strong recent rally.

Outlook

The Fund invests in a 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.

The Fund has been positioned for some time in anticipation of higher interest rates and an improving economic outlook, with an underweight exposure to interest rate-sensitive utilities and overweight exposure to toll roads, railroads and ports. This positioning served investors well in November, as active management protected capital during a turbulent period for financial markets.

The two main risks for infrastructure investors are political or regulatory uncertainty; and sharply rising interest rates. This month has seen both risks play out in a material way, leading to short term underperformance compared to global equities. Continued volatility could represent a timely opportunity for long term investors looking to make a strategic allocation to infrastructure.

Much emphasis has been placed recently on Trump's infrastructure spending program. Our Fund is not a thematic fund, that would benefit from new construction and engineering activity. Rather, it represents a fundamental asset class allocation to infrastructure; that is, real assets that can provide inflation protection and long term, steady capital growth. We remain focused on buying good quality infrastructure companies at good prices, and managing macroeconomic risks at a portfolio construction level.