First Sentier Global Listed Infrastructure Fund Monthly review and outlook

First Sentier Investors

Monthly Review and Outlook | July 2023

Market review

Global Listed Infrastructure rose in July, aided by solid quarterly earnings numbers and easing inflation rates.

The best performing infrastructure sector was Railroads (+4%), with North American freight rail stocks supported by improving service metrics and indications that rail cost inflation may be peaking. Gains in this sector were led by Union Pacific (+13%, held), reflecting a positive investor response to its new CEO.

The worst performing infrastructure sector was Towers / Data Centres (-3%) as US tower operators underperformed on concerns for a challenging leasing environment. Mobile network equipment maker Eriksson announced declining North American sales; while Nokia noted delays for some North American projects and downgraded 2023 guidance.

The best performing infrastructure region was Japan (+3%), reflecting continued outperformance from the country's electric utilities. The worst performing infrastructure region was Canada (-2%), owing primarily to underperformance from its large cap energy midstream stocks.

Fund performance

The Fund returned +0.2% after fees in July[1], in line with the FTSE Global Core Infrastructure 50/50 TR Index (SGD).

The best performing stock in the portfolio was West coast US freight rail operator Union Pacific (+13%), which surged on the news that railroad veteran Jim Vena would be appointed as the firm's next CEO. Vena has a track record of successfully implementing Precision Scheduled Railroading (a strategy that reduces costs by operating fewer, longer trains and running them on tighter schedules), both at Union Pacific where he previously served as Chief Operating Officer between 2019 and 2021, and before that at Canadian peer Canadian National Railway (flat, not held).

Canadian-listed Altagas (+9%), whose assets include high growth US natural gas utilities and strategically located energy midstream assets in Western Canada, also rose. Investors welcomed comments from its new CEO Vern Yu, who placed emphasis on strengthening the company's balance sheet; and noted a preference for contracted / regulated earnings growth.

The portfolio's energy midstream holdings delivered positive returns, as robust hydrocarbon production levels in the US drove demand for their services. Targa Resources (+8%) which operates Texas-focused networks of natural gas and natural gas liquids storage and transportation assets, built on recent gains as investors anticipated that healthy volumes would support positive earnings numbers for the June quarter. DT Midstream (+8%) outperformed, having recently reiterated confidence in its volume and earnings guidance. The build-out of new natural gas power plants and Liquefied Natural Gas (LNG) export facilities on the US Gulf Coast are expected to support its longer term growth outlook.

US utility stocks also represented an area of strength for the portfolio. New Orleans-based Entergy (+5%) increased as investors identified value following a period of underperformance. The company has a healthy forecast EPS growth rate of between 6% and 8%, reflecting the anticipated investment needed to meet rising electricity demand in the US Gulf Coast region. Dominion Energy (+3%) gained despite the sale of its stake in the Cove Point LNG export terminal to Warren Buffett-led Berkshire Hathaway for a slightly lower-than-expected price of US$3.3 billion.

The worst performing stock in the portfolio was Italian mobile tower company Inwit (-6%). Despite announcing healthy June quarter earnings, the stock underperformed following strong gains earlier in the year. The company is viewed as a potential target in the event of further consolidation within the European towers sector. US peers Crown Castle (-5%) and American Tower (-2%) also fell as concerns for slowing capex from US telecom companies (tower companies' customers) weighed on investor sentiment.

UK electric utility SSE (-5%), which operates transmission and distribution networks alongside a growing portfolio of renewables, lagged after dry and still weather conditions resulted in lower than expected output from its portfolio of North Sea wind farms during the June quarter. Broader concerns that rising costs and supply chain bottlenecks are making it harder to build offshore wind farms also weighed on sentiment towards the stock.

Fund activity

No new stocks were added to the portfolio during the month, and weights in existing holdings were generally maintained at current levels.

[1] Fund performance is based on the Singapore unit trust, net of fees, expressed in SGD terms.
All stock and sector performance data expressed in local currency terms. Source: Bloomberg.

Market outlook and fund positioning

The Fund invests in a range of listed infrastructure assets including toll roads, airports, railroads, utilities and renewables, energy midstream, wireless towers and data centres. 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 outlook for the asset class is positive. Valuations are appealing compared to historical levels; balance sheets and dividend payout levels are healthy. The most recent series of quarterly earnings results showed transport infrastructure continuing to recover from the effects of the covid pandemic; while utility and tower / data centre earnings maintained steady upward trajectories. In the event of an economic slowdown, earnings from this space are expected to be more resilient than those of global equities owing to the essential service nature of these businesses, and their regulated / contracted earnings streams.

Public policy support for infrastructure investment remains strong globally, particularly for the replacement of aged infrastructure assets and the buildout of renewables. Utilities are in the midst of a multi-decade structural growth story, driven by decarbonisation, electrification and resiliency spend.

In the communications infrastructure space, structural growth in demand for data continues to support earnings growth in the towers space. Concerns for higher interest rates and potential softness in tower leasing demand in the near term are now better reflected in valuation multiples. Data centres remain positioned to benefit from growing demand for cloud computing, driven in part by the recent surge in AI interest.

Transport infrastructure has seen a recovery in volumes, aided by the return-to-office trend and a modal shift away from public transport. For many toll roads, the high inflation of 2022 has now translated into toll uplifts. Traffic data from the Airports sector has highlighted a consistently keen appetite to travel, with the strongest recovery seen at tourism-focused airports. Travellers are now returning to the air in countries that had been slower to reopen, such as China and Japan.

Source : Company data, First Sentier Investors, as of 31 July 2023.