Listed Infrastructure—Opportunity Amid a Maturing Economic Cycle

Ben Morton, Head of Global Listed Infrastructure and Senior Portfolio Manager

Executive Summary

- **Late-cycle defense.** Our analysis of 45 years of data indicates that global listed infrastructure has tended to deliver strong absolute and relative returns in late-cycle periods, outperforming global equities by an average of 5% annually. More broadly, infrastructure has delivered equity-like returns over full market cycles, but generally with lower volatility and meaningful downside mitigation. We associate these characteristics with infrastructure’s stable cash flows, typically tied to fee-based service contracts or concessions.

- **Why infrastructure now.** We believe the backdrop for listed infrastructure remains positive amid slowing global growth: company fundamentals are generally healthy and valuations are only in line with their historical premium to global equities. Their valuations arguably should be trading above their average premium given the late stage of the cycle, indications of accommodative monetary policies being extended, and the tremendous private-market demand for infrastructure assets.

- **Infrastructure hot spots.** Industry-specific factors can present opportunities for above-average growth. We currently see particularly compelling forces at work in cell towers (continued 4G deployments, 5G rollout), midstream energy (vital to the energy value chain), renewable energy (overtaking coal as a U.S. electricity source) and freight rails (improvements in operational efficiency).

Listed Infrastructure Has Been Resilient in Late Cycles and Recessions

Excess Returns vs. Global Equities, 1973–2018

As more signals point to slowing economic growth in 2019 and beyond, we believe listed infrastructure’s history of resilience in late-cycle environments may appeal to investors looking to reduce overall market sensitivity without sacrificing the potential for attractive long-term returns.
Late-Cycle Defense

The defensive characteristics of listed infrastructure were on display in 2018 as economic and political uncertainty upended financial markets late in the year.

After lagging global equities through much of 2018, the FTSE Global Core Infrastructure 50/50 Index largely shrugged off market volatility in the final months, with a drawdown of just –2.6% in the fourth quarter versus –13.4% for the MSCI World Index (Exhibit 1). For the full year, infrastructure declined by less than half as much as global equities. As the broader stock market subsequently rebounded in the first quarter of 2019, infrastructure kept pace, in part due to more accommodative monetary postures by many of the world’s central banks.

Why has infrastructure outperformed in late cycles? We believe infrastructure’s defensive behavior stems largely from stable cash flows, resulting from distinct characteristics common to infrastructure businesses:

- **Durable assets**: Infrastructure companies own and operate tangible assets with useful lifespans typically measured in decades.
- **Monopolistic businesses**: They operate in industries with high barriers to entry due to strict zoning restrictions and large capital requirements—and in some cases exclusivity rights—which often make it prohibitive for new competitors to gain entry.
- **Inelastic demand**: The services they provide—such as basic utilities, transportation and communications infrastructure, and energy logistics—generally benefit from consistent demand regardless of economic conditions.
- **Fee-based revenues**: Infrastructure assets provide services essential to economic progress, generating cash flows from relatively secure service contracts and/or government concession agreements, many of which include inflation-linked pricing allowances.

As a result of these characteristics, infrastructure companies have historically delivered more consistent cash-flow growth compared with other equities (Exhibit 2). In addition, their cash-flow-oriented business models tend to produce attractive distributions, which may be appealing to investors in a slower-growth environment. As of March 2019, the infrastructure universe had a dividend yield of 3.4%, compared with 2.5% for global equities.

This pattern is generally consistent with infrastructure’s strong record of favorable relative performance in the later stages of economic cycles. Using a composite of infrastructure sectors in the Thomson Reuters Worldstream Index series, we analyzed infrastructure performance across different phases of the economic cycle going back 45 years.

In the six late-cycle periods since 1973—the most recent one ending in late 2007—infrastructure generated a 14.6% annualized return and outperformed global equities by roughly 5%, as shown in the chart on the cover. Listed infrastructure also significantly outperformed in recessionary periods, with a –5.1% annualized return compared with –10.2% for global equities, a similar 5% advantage.

Listed infrastructure had a fraction of the broader market’s decline in 2018’s turbulent fourth quarter.
Attractive full-cycle characteristics. Since the inception of the FTSE Global Core Infrastructure 50/50 Index in 2009, listed infrastructure has delivered competitive market performance, with an annualized total return of 9.4% through March 2019, compared with 8.7% for the MSCI World Index (Exhibit 3). Yet the group’s gains were accompanied by lower volatility—a 10.3% standard deviation of returns for infrastructure, compared with 13% for global equities over the same period. Infrastructure stocks also provided significant downside mitigation, falling by half as much as broader stocks in down markets on average.

We believe the defensive characteristics of infrastructure may draw increasing attention as investors seek to navigate a maturing economic cycle.

Exhibit 2: Consistent Cash-Flow Growth Across Market Cycles
Annual EBITDA Growth(a)

<table>
<thead>
<tr>
<th>Year</th>
<th>Global Infrastructure</th>
<th>Global Equities</th>
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</thead>
<tbody>
<tr>
<td>2006</td>
<td>5.6%</td>
<td>5.4%</td>
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<tr>
<td>2007</td>
<td>6.4%</td>
<td>6.2%</td>
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<tr>
<td>2008</td>
<td>7.1%</td>
<td>6.8%</td>
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<tr>
<td>2009</td>
<td>7.8%</td>
<td>7.5%</td>
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<tr>
<td>2010</td>
<td>8.5%</td>
<td>8.2%</td>
</tr>
<tr>
<td>2011</td>
<td>9.2%</td>
<td>8.9%</td>
</tr>
<tr>
<td>2012</td>
<td>9.8%</td>
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</tr>
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<td>10.5%</td>
<td>10.2%</td>
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<tr>
<td>2014</td>
<td>11.2%</td>
<td>10.9%</td>
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<tr>
<td>2015</td>
<td>11.9%</td>
<td>11.6%</td>
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<tr>
<td>2016</td>
<td>12.6%</td>
<td>12.3%</td>
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<tr>
<td>2017</td>
<td>13.3%</td>
<td>13.0%</td>
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<tr>
<td>2018</td>
<td>14.0%</td>
<td>13.7%</td>
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Exhibit 3: Infrastructure Risk/Return Characteristics
2009–1Q 2019

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<th>Annualized Total Return</th>
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<td>Global Infrastructure</td>
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Data quoted represents past performance, which is no guarantee of future results. (a) Annual Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) growth percentage is calculated as a weighted average of all constituents in the index; exclusions are applied to constituents with EBITDA growth of +/- 200%

Global Listed Infrastructure represented by the FTSE Global Core Infrastructure 50/50 Net Tax Index. Global Equities represented by the MSCI World Index. See back page for additional disclosures.

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Data quoted represents past performance, which is no guarantee of future results. The information presented above does not reflect the performance of any fund or account managed or serviced by Cohen & Steers. There is no guarantee that any historical trend illustrated herein will be repeated in the future, and there is no way to predict precisely when such a trend will begin. An investor cannot invest directly in an index, and index performance does not reflect the deduction of any fees, expenses or taxes. See back page for index associations and additional disclosures.
Why Global Listed Infrastructure Now

**Stable fundamentals.** Demand for essential services continues to be resilient, despite slowing global growth. In addition, through our analysis, we think infrastructure companies continue to see substantial investment opportunities, driven by critical system upgrades to ensure adequate levels of service quality and the need to accommodate evolving supply and demand dynamics for specific infrastructure services.

**Attractive value relative to global equities.** While infrastructure stocks historically have traded at a premium to global equities, the degree of that premium has narrowed, as highlighted in Exhibit 4 below. With the global economy shifting into a lower gear and amid a more-dovish environment for interest rates, investors may find current relative valuations to be compelling.

**Low correlations.** Global listed infrastructure has historically been an effective diversifier, illustrated by its relatively low correlations with other asset classes. After spiking in the wake of the financial crisis, correlations with global equities have since returned to previous long-term levels, with a correlation to global equities of 0.65 (2010 through March 2019). We believe infrastructure’s diversification potential may be especially important heading into what could be a period of potentially lower market returns.

**Support from private investment demand.** Amid tremendous interest for real assets from private investors, managers of private infrastructure funds have been raising capital faster than they can put it to work, creating a record $180 billion backlog of dry powder looking to buy infrastructure assets (Exhibit 5).

We believe this capital could benefit the public infrastructure market in two ways: a) private investors paying premium prices for assets, potentially driving higher valuations for listed company assets and b) acquisitions of public companies by private entities, creating the prospect for shareholders to realize additional value. As an indication of the potential valuation support this could provide, our analysis

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**Exhibit 4: Global Infrastructure Valuations vs. Global Equities**

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<th>Global Equities</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>10.3x</td>
<td>11.6x</td>
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<tr>
<td>2012</td>
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At March 31, 2019. Source: FTSE, MSCI, FactSet.

(a) EV/EBITDA refers to the ratio of enterprise value to earnings before interest, taxes, depreciation, and amortization using current fiscal year estimates. (b) Average represents historical average based on monthly data starting November 30, 2011, which is the earliest date available for these metrics, and ending as of the most recent quarter-end data available. See back page for additional disclosures.
of recent private transactions indicates that investors have been acquiring assets at an average of nearly 18x year-ahead cash flows, compared with a 11.5x average cash-flow multiple for the listed infrastructure universe.

Countries globally have an increasing desire to spend more on infrastructure.

**Long-term need for infrastructure investment.** After 50 years of underinvestment and deteriorating service quality in many developed countries, governments have begun approaching infrastructure spending as a tool to stimulate growth and improve their global competitiveness. This shift in attitude comes at a crucial time, as headline events ranging from Flint, Michigan-type water crises to the latest freight or passenger train derailment have reinforced the pressing need to spend more on infrastructure modernization in developed countries.

Data quoted represents past performance, which is no guarantee of future results. See back page for index associations, definitions and additional disclosures.
At the same time, emerging countries are seeing demographically fueled growth in new infrastructure aimed at delivering higher standards of living. As plans proceed in both developed and emerging economies, there will likely be growing incentives for increased private investment in infrastructure and privatization of key assets.

**Infrastructure Hot Spots**

We believe it is important to look not just at infrastructure fundamentals overall, but at individual sectors and companies, since supply and demand dynamics can vary significantly. Below is our view of select themes.

**Cell Towers**

Cell tower owners are seeing a long runway of growth, benefiting from spending on networks by wireless carriers to support fast-rising growth in data usage; 4G deployments continue to be robust, while the 5G rollout is in its early stages.

**Midstream Energy**

Midstream companies are seeing fundamental tailwinds as North American energy production reaches record levels. At the same time, managements are embracing smarter and more return-driven business models.

**Renewable Energy**

The years ahead will likely see an upswing in renewable energy use, as an increasing number of countries and companies embrace the generation of sustainable energy, and the industry is evolving swiftly.

**Freight Rails**

The fundamental outlook for freight railways remains attractive, as improvements in operational efficiency and declining capital investments could significantly increase company free-cash-flow generation over the next several years.
Takeaways

Infrastructure’s strong relative performance since October highlights the potential benefits of having defensive, fee-based revenues and high dividend yields in an environment of potentially lower market returns.

In late cycles, investors can prepare with diversification ahead of market volatility.

We believe listed infrastructure provides a compelling way to diversify in today’s market, offering attractive relative valuations, low correlations with equities and the backing of robust demand from the private market.
Index Definitions
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