Brookfield

Portfolio Manager Q&A: Why to Consider Investing in Infrastructure Equities

We recently sat down with Tom Miller and Leonardo Anguiano, co-portfolio managers for Brookfield's Global Listed Infrastructure (GLI) Strategy. We discussed how global listed infrastructure can help enhance portfolios, where the opportunities are among infrastructure sectors, and more. Please find excerpts from the conversation below.

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Q. What role can global listed infrastructure play in a diversified global portfolio?

A: We believe global listed infrastructure has a critical role to play in portfolios via a long-term strategic allocation. Infrastructure companies—across transportation, energy, communications and utilities—own assets that are essential to the economy, so they generally have steady or inelastic demand. They also are typically highly cash generative, with contracted or regulated revenue streams frequently linked to inflation, resulting in stable and predictable long-term cash flows that tend to be insulated from fluctuations in supply-and-demand dynamics. Thanks to these characteristics, infrastructure equities have historically provided stable earnings, an attractive risk/return profile and strong investment returns.

Q: How can global listed infrastructure potentially enhance a global equities portfolio?

A: We find that global infrastructure equities have historically generated more consistent and higher cash flows than global equities and have provided higher income and capital appreciation than the broader global equity market. They also have exhibited positive sensitivity to inflation, outperforming global equities historically during periods of elevated inflation.

In addition, we believe the essential nature of infrastructure makes the asset class less susceptible to economic downturns and volatile markets, and therefore can be defensive in periods of economic contraction and uncertainty. Our research shows public infrastructure tends to outperform broader equities in down markets. We believe infrastructure can offer a defensive equity allocation that may be able to better weather market volatility related to today's uncertain economic environment than global equities, whether as a stand-alone allocation or as a complement to other minimum volatility strategies.

Q: How can global listed infrastructure be a proxy for global equities?

A: While global listed infrastructure companies have lower sensitivity to the economic outlook and, thus, have a lower beta to global equities, they are listed instruments. As a result, they still exhibit a positive correlation to broader equity markets. The structural growth we see embedded across our sectors—including from decarbonization/electrification

opportunities for utilities, the impact of increasing mobile data consumption on the need for towers, and the continuing penetration of air travel driving passenger growth at airports—drives certainty of cash flows with high visibility. Therefore, allocating to global listed infrastructure in lieu of global equities could potentially provide a similar or better long-term earnings growth outlook with what should be much lower risk, given the contractual or regulated underpinning.

Q: How can global listed infrastructure potentially enhance a private infrastructure portfolio?

A: The potential benefits of infrastructure—compelling returns, defensiveness and inflation protection—can be found in both public and private markets. However, we believe an investing approach that includes both public and private exposures can offer liquidity, portfolio completion and tactical asset allocation benefits.

Public infrastructure's liquidity profile can allow investors to maintain a consistent level of exposure to the asset class, serving as a sleeve to manage capital committed to, and recycled from, private infrastructure investments. The addition of a public infrastructure allocation also can help mitigate private-fund concentration risk over the long term and provide investment opportunities that are more difficult to access in a private portfolio. Finally, public infrastructure can be used to potentially take advantage of dislocations between market prices and the intrinsic values of underlying infrastructure assets

Q: What is Brookfield's approach to investing in global listed infrastructure?

A: Our investment philosophy centers on investing in high-quality, well-managed and well-financed infrastructure companies that are attractively priced below their intrinsic value. We invest in listed infrastructure across geographies and sectors, seeking to capture the exciting opportunities across the evolving asset class.

We utilize a value-based investment process emphasizing fundamental, bottom-up research to identify high-quality, attractively priced securities. We determine portfolio construction based on a combination of our research convictions, return expectations and risk parameters, constructing relatively concentrated portfolios of approximately 30 to 60 securities.

Q: As investors adjust to a higher-for-longer interest rate environment, what is the impact to listed infrastructure companies?

A: We are optimistic about our asset classes in a higher-for-longer environment. If interest rates are high because of inflation and inflation expectations remain elevated, our companies stand to benefit from an uplift in cash flows due to inflation linkage in regulatory frameworks or contracts. Meanwhile, if interest rates are high because real rates (interest rates adjusted for inflation) remain elevated, we believe the chances of a hard economic landing increase. In a recessionary environment, investors typically turn to defensive plays, such as infrastructure.

Q: How is the energy transition megatrend shaping listed infrastructure companies?

A: We believe the utilities that own electricity transmission and distribution assets will play a key role in a successful energy transition, as they connect sources of renewable supply with power demand. As the energy transition progresses, we expect substantial investment will be needed to build and upgrade transmission and distribution infrastructure so it can connect sources of renewable supply with power demand. This should support the capital investment and earnings growth outlook for related utilities. We are already seeing such opportunities emerging in the U.S., the U.K. and Europe.

There also are signs emerging that energy infrastructure companies will have a role to play in future energy transition initiatives, such as hydrogen transportation and storage, and carbon capture and storage (CCS). In the U.S., the Inflation Reduction Act provides new tax incentives that should serve to meaningfully accelerate adoption of these technologies and further drive down costs, helping to make these projects economically competitive.

Q: Why are the growth prospects of utility companies underappreciated by the market?

A: We believe U.S. utilities have improved fundamentals and better operating efficiency and will play a key role in ensuring a successful energy transition. These factors are fueling a stronger growth outlook for the sector, which has the potential to offer attractive returns in a relatively safe market. However, the broader market appears to still view these companies as slow-growing bond proxies. In our view, this misperception represents a compelling opportunity within an actively managed, diversified infrastructure equities portfolio.

Q: What is your outlook for the communications sector?

A: We remain focused on companies outside of the U.S., a stance that has performed favorably so far this year. U.S.-based tower companies have suffered not only due to the rise in interest rates, but also due to fears of an upcoming slowdown in growth caused by a deceleration of network spending by the major mobile network operators. We believe this slowdown is in line with historical cycles, as the network operators rushed at once to deploy their 5G spectrum across the towers, similar to how they behaved during the initial rollout of the 4G spectrum. This dynamic has led to a higher-than-expected peak in network spend and, thus, tower growth, and therefore we believe the slowdown is really just a normalization back to trend levels.

In our opinion, the main driver of growth long term for towers continues to be increasing mobile data consumption, a trend we do not see changing anytime soon. To the extent this risk continues to be mispriced by the market, it could present us with some interesting opportunities to increase our exposure to the sector.

More broadly, we believe the long-term outlook for global infrastructure securities is attractive from a supply-and-demand perspective. Investor interest in infrastructure has increased dramatically in recent years due to a combination of global population growth and a deficiency in government budgets to fund much-needed spending on infrastructure.

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