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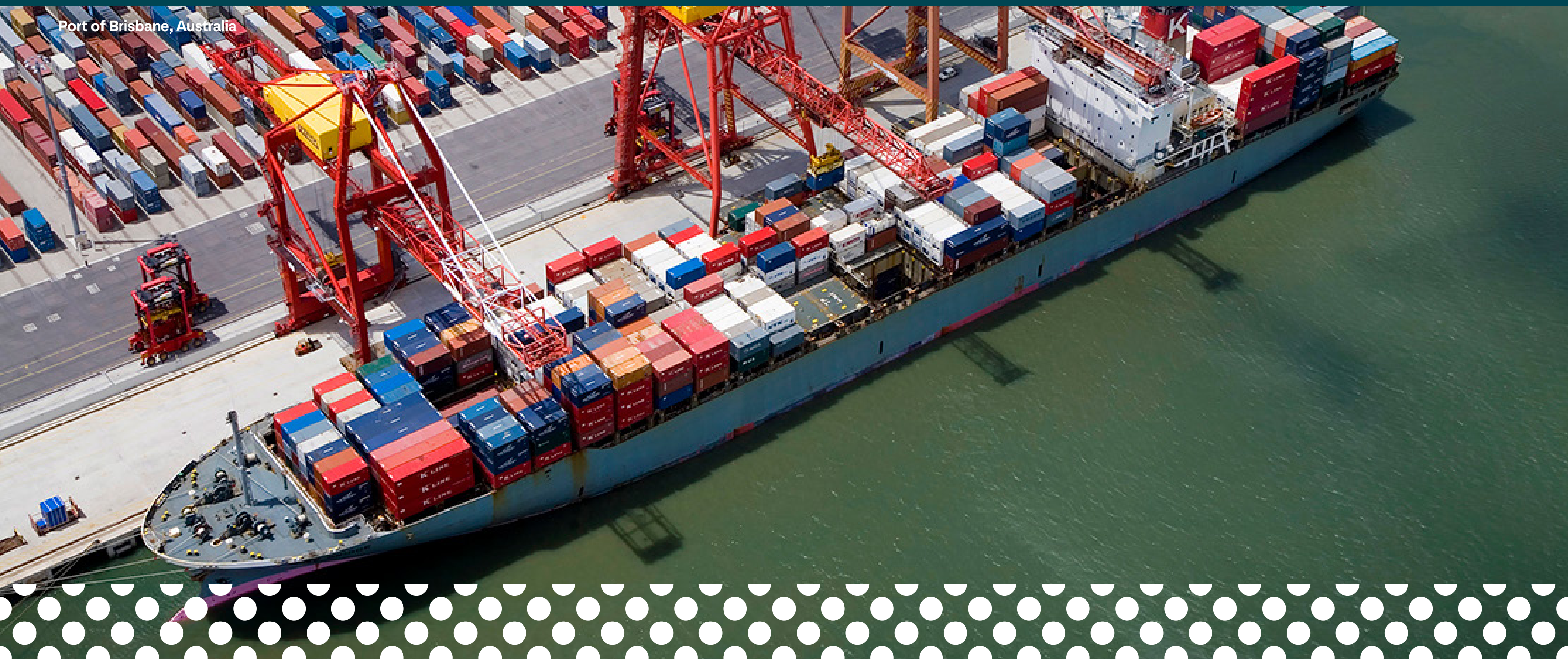

Port of Brisbane, Australia

The infrastructure opportunity

Part 1 The role of infrastructure in long-term resilient portfolios

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At a glance

- Given the uncertain macro and geopolitical outlook, portfolios need to be built for resilience across a range of outcomes
- Unlisted infrastructure can enhance portfolio resilience while delivering diversified, low-correlation long-term returns
- Greater allocation to private markets can be a welcome reprieve from the difficult-to-price risks that impact public markets.

In the post-COVID era, economies and markets have faced a series of exceptionally disruptive events that have heightened complexity and risk in the investment environment to a level not experienced for decades. This challenging environment, marked by increased macroeconomic and geopolitical instability, shows limited signs of abating and will likely endure for some time yet. See Appendix - 'Macro challenges for asset allocators'.

As investors seek to navigate this tricky terrain, their focus is on building robust portfolios that are resilient to the long-term effects of market shocks and volatility. In this context, there lies an opportunity to expand traditional approaches to portfolio construction to include a greater allocation to unlisted infrastructure.

The infrastructure advantage

To navigate today's challenging environment, some investors seek more tactical approaches, such as moving up the risk/return curve or increasing allocations to fixed income products. These options may be suitable depending on one's investment goals or risk appetite, but both bring added investment or volatility risk.

A compelling alternative that has gained traction in recent years is increasing allocations to private market assets, specifically unlisted core infrastructure equity. This strategy appeals particularly to long-term investors who are comfortable with the associated illiquidity risk.

Unlisted infrastructure can enhance portfolio resilience and deliver diversified, low correlation, risk-adjusted returns over the long term. Its inherent characteristics – long-term, predictable revenue streams, performance through economic cycles and a differentiated risk/return profile – can make it a valuable addition to a portfolio.

Resilience through all seasons

As market dynamics have become more complex, traditional asset class correlations are higher than they have been in prior decades.

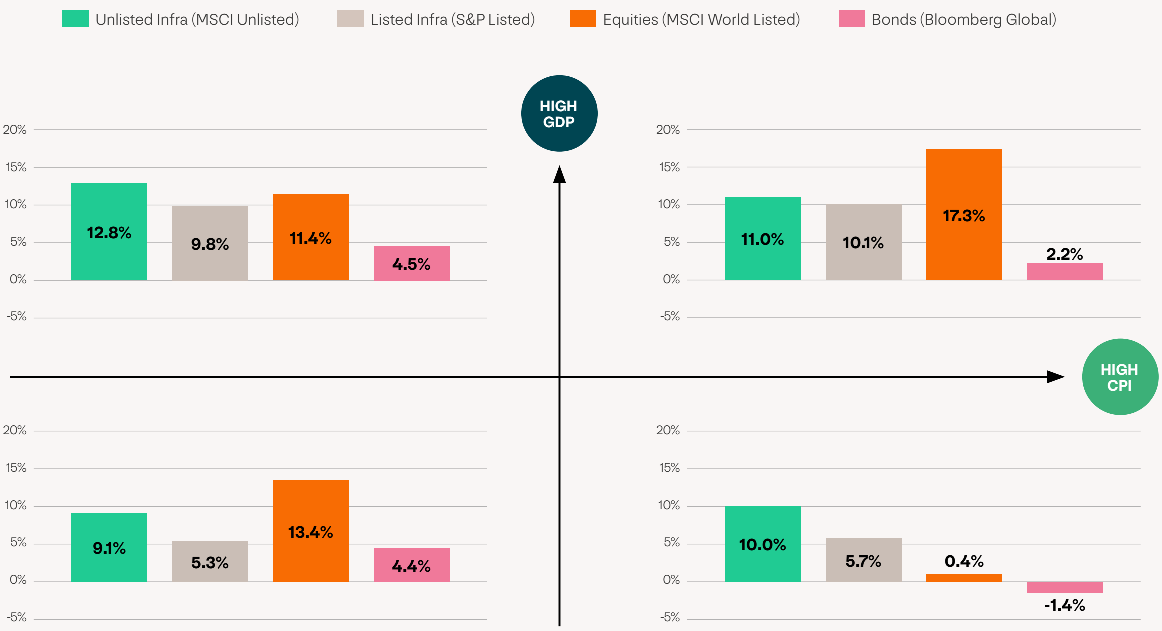
While listed equities have shown weakness and increased volatility, bonds have not provided a reliable counterweight. Unlisted infrastructure, however, has shown long-term resilience across various economic environments.

Our analysis from March 2010 to June 2023 (Figures 1 and 2) demonstrates that unlisted infrastructure, represented by the MSCI Global Unlisted Infrastructure Index, consistently delivers returns across different economic scenarios, including varying levels of inflation, interest rates and economic growth.

In Figure 1, we analysed varying returns from unlisted infrastructure, listed infrastructure, equities and bonds in four scenarios, combining high and low US GDP growth and CPI levels (measured relative to approximate average levels of 2%).

FIGURE 1

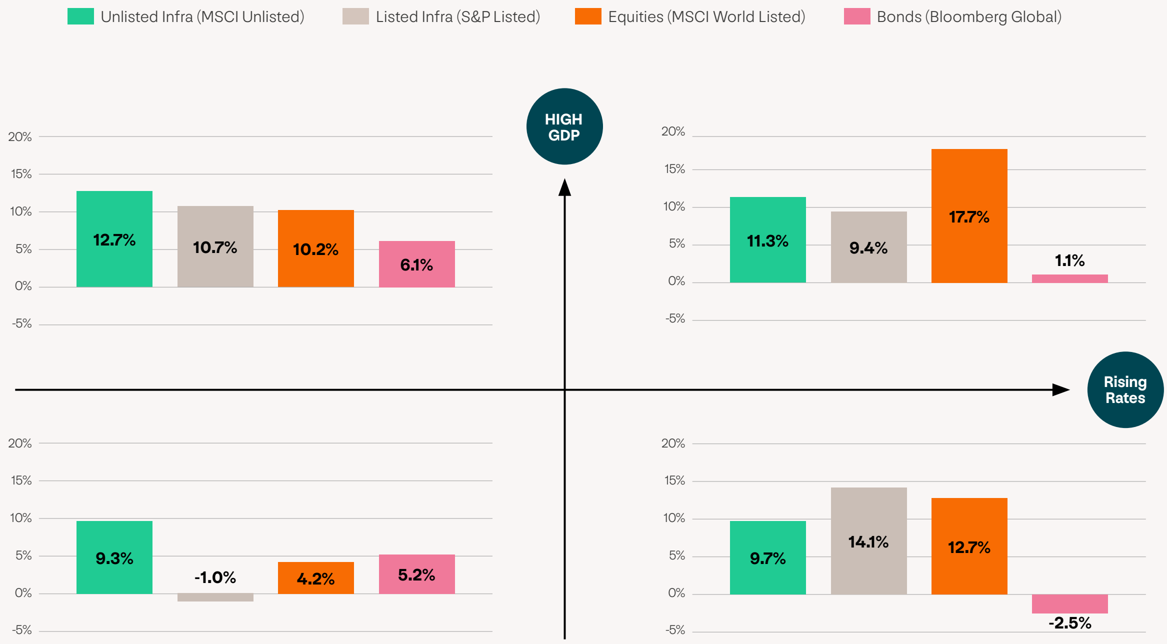
IMPACTS OF GDP AND CPI MOVEMENTS (31 MARCH 2010 TO 31 DECEMBER 2023)



Source: IFM, MSCI, Bloomberg, The Organisation for Economic Co-operation and Development, S&P Capital IQ.
Private Infra proxied using MSCI Global Quarterly Private Infrastructure Asset Index (Unfrozen) – Local currency ("MSCI Unlisted"), Listed Infra proxied using S&P Global Infrastructure USD Hedged Net Total Return Index ("S&P Listed"), Equities proxied using MSCI World 100% Hedged to USD Net TR USD ("MSCI World Listed"), Bonds proxied using Bloomberg Global-Aggregate Total Return Index Value Hedged USD ("Bloomberg Global"). High/Low CPI and GDP are based on US Consumer Price Index (CPI) and US real Gross Domestic Product (GDP), respectively, and are defined as quarterly changes on the annual four-quarterly rolling basis exceeding or falling below a 2% threshold. Total returns represent the annual four-quarterly rolling data from 31 March 2010 to 31 December 2023.

FIGURE 2

IMPACTS OF GDP AND RATE MOVEMENTS (31 MARCH 2010 TO 31 DECEMBER 2023)



Source: IFM, MSCI, Bloomberg, The Organisation for Economic Co-operation and Development, S&P Capital IQ.
Private Infra proxied using MSCI Global Quarterly Private Infrastructure Asset Index (Unfrozen) – Local currency ("MSCI Unlisted"), Listed Infra proxied using S&P Global Infrastructure USD Hedged Net Total Return Index ("S&P Listed"), Equities proxied using MSCI World 100% Hedged to USD Net TR USD ("MSCI World Listed"), Bonds proxied using Bloomberg Global-Aggregate Total Return Index Value Hedged USD ("Bloomberg Global"). High/Low GDP are based on US real GDP and are defined as quarterly changes on a four-quarterly rolling basis exceeding or falling below a 2% threshold. Rising/falling rates are defined as absolute changes in US 10-Year Treasury Yield over the four-quarter period exceeding or falling below a 2% threshold. Total returns represent the annual four-quarterly rolling data from 31 March 2010 to 31 December 2023.

Unlisted infrastructure investments demonstrated double digit returns in all environments, except for slightly lower returns (just under 10%) in the low CPI/low GDP growth scenario.

In contrast, listed equities performed poorly in the stagflation scenario (low GDP/high CPI), averaging just 2.4% annual returns.

Unlisted infrastructure's performance reflects the market's understanding of the inherent characteristics of infrastructure assets, which continue to provide value in various market environments. This value has its foundations in the essential nature of the services infrastructure provides to communities, including energy, transportation and digital connectivity, as well as its secure market position, with high barriers to entry and a limited availability of substitutes.

In Figure 2, we similarly examined returns under four different economic scenarios, this time combining high or low US GDP growth and rising or falling interest rates on 10-year US Treasury bonds. Unlisted infrastructure performed well in all four environments, returning around 10% per annum.[1] Once again, these consistent returns reflect the inherent characteristics of infrastructure that make it resilient to macro conditions, as well as the sector's consistent track record of skilful asset management and alpha generation.

Long-term, predictable revenue streams

Core infrastructure businesses are defined by their long-term, predictable revenue streams, which are typically linked to inflation and, in some subsectors, may also benefit from economic growth.

Revenues fall into four categories: contracted, regulated, volume-linked and market-related. Contracted and regulated revenues provide the greatest downside protection, while volume-linked and market-related revenues show a greater correlation with economic activity.

Diversification across these categories is key to building a resilient infrastructure portfolio that provides the greatest potential for meaningful upside returns.

[1] Reflects gross annualised asset level returns

A differentiated risk/return profile

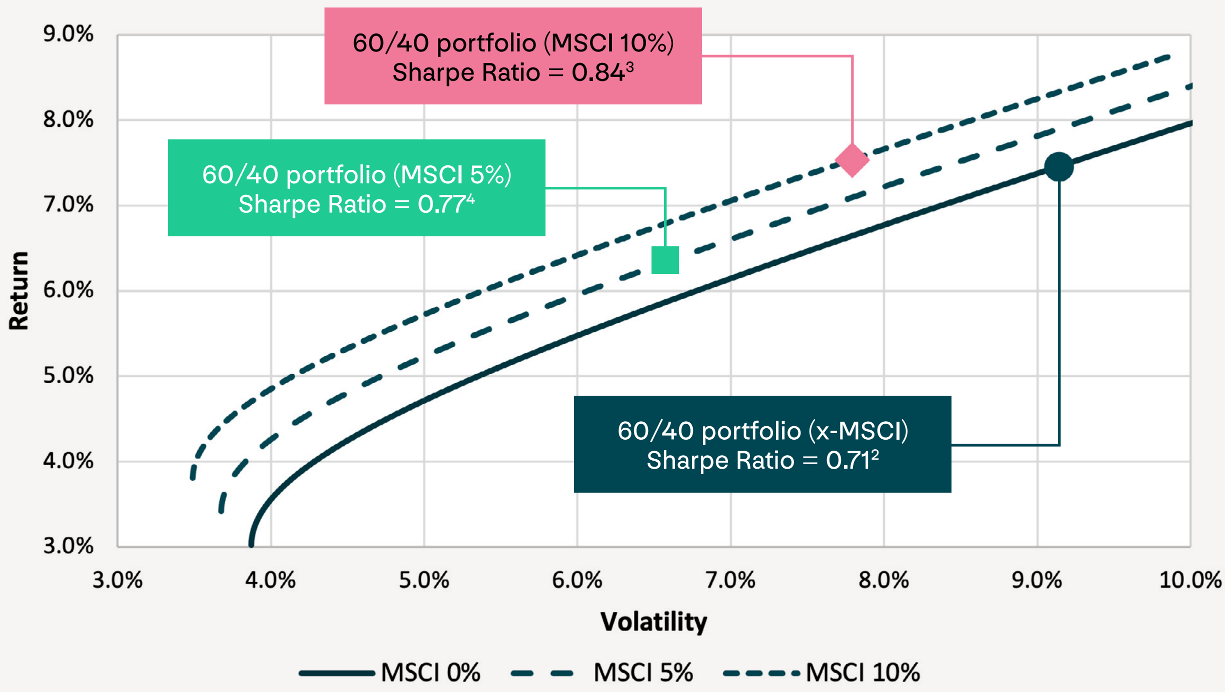
Successful portfolio construction is underpinned by differentiated risk, volatility and correlation properties, all of which can be improved by the inclusion of unlisted infrastructure.

The recent risk of stagflation and central banks' moves to increase interest rates in response showed that traditional diversification approaches, which rely predominantly on public markets, have their limitations. When monetary policies are extreme, asset prices can become distorted, making them inconsistent with their true values and creating risks that are unevenly distributed. In these scenarios, greater allocation to private markets can be a welcome reprieve from the difficult to price risks that impact public markets.

Adding unlisted infrastructure to existing investor portfolios can, therefore, materially improve risk-adjusted returns and enhance overall performance (Figure 3). Historical data, once again using the MSCI Global Unlisted Infrastructure Index as a proxy, shows that unlisted infrastructure has low correlations with both equities and fixed income, as well as a positive Sharpe ratio outcome. Therefore, including unlisted infrastructure in a portfolio is likely to have a meaningful positive impact on risk-adjusted returns for investors.

FIGURE 3

EFFICIENT FRONTIER OF AN EQUITIES/FIXED INCOME/INFRASTRUCTURE PORTFOLIO, (MARCH 2010 TO DECEMBER 2023)[1]



Source: IFM Investors

[1] Reflects the risk-return profile of the portfolio based upon the performance from March 2010 to December 2023, with different allocations in equities (MSCI World Total Return Index Net Hedged USD), debt (Bloomberg Global-Aggregate Total Return Index Value Hedged USD) and unlisted infrastructure (MSCI Global Quarterly Private Infrastructure Asset Index Unfrozen Local Currency). The Sharpe Ratio is calculated using the performance in excess of the risk-free rate of returns (1% p.a.) for each portfolio divided by the standard deviation of the performance. The model portfolios and the accompanying results are shown for illustrative purposes to demonstrate the potential risk/reward trade-offs of having exposure to unlisted infrastructure. This information does not constitute a recommendation of exposures for any client portfolio or guarantee the performance of an investment in such portfolio.
[2] Represents the portfolio with an allocation of 60% in equities and 40% in fixed income.
[3] Represents the portfolio with an allocation of 60% equities (including 10% MSCI) and 40% fixed income.
[4] Represents the portfolio with an allocation of 60% equities (including 5% MSCI) and 40% fixed income.

Past performance does not guarantee future results.


Sydney Airport, Australia

The long-term view: building a robust portfolio

Timing the market cycle for unlisted infrastructure investments can be challenging. The benefits of diversification come from building a target allocation over time, treating unlisted infrastructure as a buy-and-hold asset class for long-term investors.

These long-term investments in unlisted infrastructure discount shorter-term macro risks, which often drive listed asset volatility without affecting the underlying drivers of their valuations. Thus, this relatively stable performance through various parts of the cycle supports a long-term approach to this asset class.

Given the uncertain macro and geopolitical outlook, portfolios need to be built for resilience across a range of outcomes, rather than simply focusing on investments that benefit from economic growth or those that offer protection during downturns. A more sophisticated approach to portfolio diversification, both across and within asset classes, is needed to build portfolios that continue to perform well across changing macroeconomic and geopolitical environments.

We see an opportunity for investors to be strategic and tactical in their allocations to maximise risk-adjusted returns. To this end, an allocation to unlisted infrastructure is a proven method of improving long-term, risk-adjusted portfolio performance.

Unlock more infrastructure expertise.

To learn more about how we seek to maximise the inherent characteristics of infrastructure and the opportunity they present, read our companion paper, *The infrastructure opportunity - making the most of infrastructure allocation.*

APPENDIX

Macro challenges for asset allocators

The post-COVID environment is marked by ongoing macroeconomic and geopolitical instability and uncertainty, as well as several global trends that have implications for the investment environment. In this context, conventional portfolio construction wisdom is being challenged and investors are considering a broad range of strategies to manage the associated risks and opportunities.

We foresee **a secular shift in interest rates** following the period of pandemic-related volatility. The traditional investment strategy of 60% equities and 40% bonds, which performed well when interest rates were falling, may be challenged by this new environment.

As central banks **continue to withdraw liquidity**, investors will need to become more proactive in managing investments within and between asset classes. This has already occurred in bond markets, where central bank policies have kept yields artificially low. Even as underlying inflation returns to central bank targets over the longer term, there remains **a heightened risk of more frequent inflationary shocks** over the next decade. This volatility can be influenced by geopolitical events and major long-term trends.

The rise of interventionist and populist governments carries **fiscal policy risks**, including protectionist trade measures, unpredictable regulatory changes and increased public debt from expansionary fiscal policy. These risks may, however, create opportunities for private capital to invest in assets and sectors that have traditionally been the purview of governments.

Ageing populations and slowing or negative population growth is a key **demographic trend** in developed countries, which is likely to dampen potential growth.

Geopolitical and geo-economic risks arise from a more divided geopolitical landscape. Confrontational foreign policies may lead to regionalisation and the fragmentation of global trade, with a shift towards partnerships based on political alignment rather than geographic or economic reasons. The **transition to a net-zero economy** is likely to be disruptive and may have a short-term impact on investors' costs and returns. The impact of this trend will depend in large part on transition paths and policies adopted to achieve net-zero emissions.

The emerging **AI boom and the importance of technology** in global politics present risks of job market instability, with significant potential effects – both positive and negative – on economic growth, productivity and inflation. AI, in particular, poses risks due to its ability to be used for nefarious purposes, such as to conduct cyberattacks or propagate deep fakes and misinformation.

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