Value Strategy

MONTHLY COMMENTARY | OCTOBER 2021

Our global listed infrastructure strategies performed in line or better than a range of infrastructure benchmarks, which underperformed global equities for the month.

Macroeconomic factors continued largely in the same vein as in previous months, with the markets focused on supply chain disruptions and the sustained high level of inflation, including high energy prices.

Economic activity continued to rebound, albeit slightly below expectations, largely as a result of supply chain disruptions. Inflation remained high and, combined with high energy prices and strong wage and labour data, increased the markets' expectation that interest rate increases will be bought forward.

Mobility restrictions continued easing as COVID-19 vaccine rollouts carried on strongly in many regions and as some regions such as Asia Pacific moved away from a zero-COVID-19 strategy.

Ongoing COVID-19 disruption, supply chain issues and high inflation have the potential to delay the full economic recovery; however, markets are not signalling increased odds of a recession, despite yield curves flattening.

Portfolio Performance

On a regional basis, the U.S. and Canada region was the top contributor to monthly performance (+4.26%), of which U.S. rail operators Union Pacific (+1.00%) and CSX (+0.57%) were the lead performers.

Union Pacific is the largest listed railroad company in North America.

CSX is one of five leading North American rail companies, with over 21,000 miles of rail, covering 23 states and 40+ ports. CSX is engaged in the transportation of rail freight in the Southeast, East and Midwest via interchange with other rail carriers, to and from the rest of the U.S. and Canada.

Union Pacific and CSX performed well in October after both companies beat market expectations on their third-quarter results. The beats were largely driven by strong pricing and healthy commodity/coal volume driven by the current energy crisis. Furthermore, the fear of rising corporate tax rates, which would have affected railroads, seems to have dissipated with Biden turning his attention to billionaires.

Elsewhere in the region, U.S. electric utility Exelon (+0.46%) and U.S. renewables utility Clearway Energy (+0.35%) also performed well during the quarter.

Exelon is a U.S. energy provider with one of the cleanest and lowest-cost power generation fleets. Its utilities serve millions of electric and gas customers across Delaware, Illinois, Maryland, New Jersey, Pennsylvania and the District of Columbia. The share price of Exelon benefitted from optimism surrounding a stimulus bill and reconciliation pass-through that would de-risk nuclear cash flows from a magnitude and timeframe perspective.

Clearway Energy primarily owns and operates contracted renewable generation assets in the U.S. It also owns and operates conventional generation and thermal infrastructure assets. Clearway Energy's share price rallied with the completed sale of its thermal assets, which at USD$1.9 billion was above street expectations of USD$1.3 billion. Additionally, there was optimism surrounding a stimulus bill pass-through which contains renewables subsidies.

Japanese rail operator East Japan Railway (-0.36%) was the largest detractor from monthly performance.

East Japan Railway (JR East) is Japan's largest passenger railway operator. Transporting 17 million passengers per day, JR East operates the Shinkansen high-speed rail lines north of Tokyo, as well as commuter trains within the Tokyo metropolitan network. Shares were weak due to ongoing concerns around COVID-induced mobility restrictions impacting traffic volumes. As Japan exits its state-of-emergency lockdowns, and reintroduce their 'go-to-travel' campaign, we would expect traffic to rebound.

All returns are in local currency.

Positioning and Outlook

On a regional level, the Strategy’s largest exposure is in the U.S. and Canada (58%) and consists of exposure to regulated and contracted utilities (32%) and economically sensitive user pays infrastructure (26%).

For the **Global Infrastructure Value Strategy**, the primary quantitative tool in portfolio construction is excess return, on which our stock-ranking system is based. As such, driven by valuation, the Investment Committee initiated positions in U.S. energy infrastructure company Williams Companies and Canadian energy infrastructure company Gibson Energy.

The strategy also used the opportunity to crystallise some gains by exiting Australian airport operator Sydney Airport.

Monthly Stock Highlight

This month we review Spanish electric utility Iberdrola.

Iberdrola is a multinational integrated electric utility company headquartered in Spain. Iberdrola is engaged in energy networks, renewables and wholesale and retail operations. The company has expanded internationally with operations in the U.K. (via Scottish Power), the U.S. (via Avangrid), Brazil (via Neoenergia) and Mexico.

Iberdrola’s asset base consists of a regulated energy network business and one of the world’s largest portfolios of wind energy assets, which are under long-term contracts — altogether representing over 80% of its earnings and future investments. As a result, Iberdrola’s predictable long-term cash flows satisfy our definition of infrastructure.

Iberdrola was one of the first companies to recognise the scope of the opportunity in renewable generation. Through sustained investment, it has become one of the largest wind power operators in the world, with over 16GW spread across Spain, the U.K., the U.S. and other locations. Additionally, Iberdrola has a clear strategy with a large investment program over the next five years, the bulk of which will be in low-risk regulated energy networks and renewables, with decreasing exposure to market-exposed generation and supply. This will likely provide steady long-term growth of cash flows.

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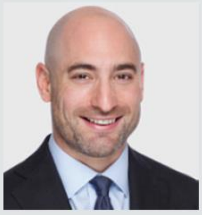

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