ClearBridge
A Franklin Templeton Company

Global Infrastructure Value Strategy

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Key Takeaways

- A growth scare and lower bond yields helped defensive areas of the market outperform in August, with global listed infrastructure making strong gains and outpacing global equities.
- Historically, infrastructure has outperformed global equities when interest rates peaked, something to keep in mind as inflation indicators slow and allow major central banks to move towards cutting rates.
- In this environment, we believe infrastructure's defensive qualities and its income stability will become more apparent, as has been evident during recent market selloffs.

Market Overview

A growth scare and lower bond yields helped defensive areas of the market outperform in August, with global listed infrastructure making strong gains and outpacing global equities.

The rotation toward a risk-off market sentiment was due to a combination of weak economic data from Europe, disappointing technology-related earnings results, softer than expected job reports from the U.S. and the unwind of the Japanese Yen carry trades.

Utilities rose as hopes increased for a September interest rate cut in the U.S., while a settlement to recover wildfire costs in California also improved sentiment for the sector. Risk-off sentiment, as well as the end of the summer travel season and deteriorating manufacturing data weighed on economically sensitive infrastructure sectors such as airports and rail.

Portfolio Highlights

Our global listed infrastructure strategies outperformed global equities, though were outpaced by relevant infrastructure benchmarks for the month.

On a regional basis, the U.S. and Canada (+1.80%) was the top contributor for month, with U.S. electric utilities PG&E Corporation (+0.34%) and NextEra Energy (+0.31%) the lead performers. PG&E is a regulated utility operating in central and northern California serving 5.3 million electricity customers and 4.4 million gas customers in 47 of the 58 counties within the state. PG&E outperformed after a fellow California utility reached a settlement to recover costs from a past wildfire. This agreement boosted market confidence that utilities will be treated fairly in future cost recovery proceedings.

NextEra is an integrated utility business with a regulated utility operating in Florida and is the largest wind business in the U.S. NextEra's regulated business, including Florida Power & Light, serves nine million people in Florida. Overall strength in U.S. utilities due to tempering bond yields and continued optimism on AI demand for power helped NextEra's share price during the month.

German airport operator Fraport (-0.08%) and U.S. rail operator CSX (-0.10%) were the largest detractors.

Fraport owns and operates one of Europe's leading hub airports at Frankfurt, one of the world's largest airports by passenger and cargo volumes. Fraport also owns and operates other airports around the world, including in Greece, Brazil and Peru. Frankfurt Airport operates within a dual-till regulatory regime. Airports lagged in August, with cooling sentiment driven by concerns around passenger traffic slowing amidst rising costs of living and aircraft supply chain issues affecting delivery of new aircrafts to airlines. We continue to look through these shorter-term issues and remain constructive on Fraport, which has idiosyncratic factors to drive outperformance. We continue to see a 'catch up' in traffic performance in 2025 and 2026 with aircraft delivery rebounding; the company should also move past the German labour strikes that affected performance in early 2024 now that labour agreements have been reached with unions. We also look forward to the end of an elevated capex cycle, with the completion of the expansions at Frankfurt T3 and Lima positioning Fraport to transition to a free cash flow positive business.

CSX operates the second-largest listed U.S.-centric railroad in terms of market cap, operating in the East Coast. The company owns over 20,000 miles of track and operates across 23 states. CSX was slightly weaker as potential strikes at the East Coast ports saw a diversion of traffic to the west, causing some volume loss for the company.

During the month, we initiated positions in Spanish airport operator Aena and U.S. electric utility WEC Energy. We also used the opportunity to crystallise some gains by exiting our positions in Danish renewables utility Orsted and U.S. rail operator Norfolk Southern.

All returns are in local currency.

Positioning and Outlook

Historically, infrastructure has outperformed global equities when interest rates peaked, something to keep in mind as inflation indicators slow and allow major central banks to move towards cutting rates. In the current cycle, peaking interest rates have created a significant opportunity, as listed infrastructure has underperformed general equities, making the sector more attractively valued.

We are expecting bond volatility to reduce and market excitement for AI and technology-related stocks to dissipate. In other words, market breadth should broaden. Therefore, as that occurs, we are expecting that the market will begin to recognise the strong fundamentals and long-term themes of the infrastructure asset class, especially higher-growth utilities.

Given the prospect of slowing growth from elevated levels, it's not surprising to see equity market volatility. In this environment, we believe infrastructure's defensive qualities and its income stability will become more apparent, as has been evident during recent market selloffs. Regulated utilities (the bulk of the portfolio) have inelastic demand and capital expenditure plans agreed with regulators on which they earn an allowed return. In a slowing growth environment, we believe that this predictability of earnings makes utilities attractive. Further, we continue to see positive earnings revisions for regulated and contracted utilities, based on that pass-through of inflation and on the growth in their underlying asset bases.