ClearBridge
A Franklin Templeton Company

Global Infrastructure Income Strategy

Daniel Chu, CFA
Director, Portfolio Manager

Charles Hamieh
Managing Director, Portfolio Manager

Shane Hurst
Managing Director, Portfolio Manager

Nick Langley
Managing Director, Portfolio Manager

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 (+1.94%) was the top contributor for month, with U.S. electric utilities NextEra Energy (+0.27%) and Entergy (+0.25%) the lead performers. Entergy is a pure regulated electric utility, providing services to approximately three million people in Arkansas, Louisiana, Texas, Mississippi and New Orleans. Entergy's share price rose as the company secured its multiyear plan with constructive terms across its largest jurisdiction in Louisiana.

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.

French airport operator Aeroports de Paris (-0.06%) and U.K. water company Pennon (-0.06%) were the largest detractors.

Aeroports de Paris (**ADP**) owns and operates three airports in Paris, including Charles de Gaulle (**CDG**), Orly and Le Bourget, as well as minority stakes in several global airport groups, including TAV in Turkey and Schiphol in Holland. 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 ADP, which has idiosyncratic factors to drive outperformance. We continue to see strength in their international platforms, particularly in the Middle East and India, where traffic performance remains buoyant and growing.

Pennon is a U.K. water and waste services company comprising two wholly owned water utilities: South West Water (**SWW**) and Bournemouth Water. Pennon's share price fell on the back of the U.K. bond yield rebounding after a decline in July, coupled with uncertainties around the water companies' response to the PR24 Draft Determination published by Ofwat.

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 U.K. water company United Utilities and U.S. electric utility Southern Company.

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.

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