Emerging Markets Strategy

MONTHLY COMMENTARY | JULY 2022

The Emerging Markets Strategy underperformed infrastructure benchmarks, while both underperformed global equities for the month.

The outlook for interest rates and inflation continues to cause volatility in markets as investors digest expectations of a global slowdown in growth in conjunction with central bank tightening, with the expectation that inflation and central bank hawkishness is close to its peak.

Inflation remains a large risk to economic growth as increasing energy prices and a higher cost of living pressure the average consumer. The probability of a recession continues to increase, as consensus expectations move closer to a recession as a base case.

Portfolio Performance

On a regional basis, Latin America was the top contributor to monthly performance (+0.44%), of which Brazilian electric utilities Equatorial Energia (+0.23%) and CPFL Energia (+0.21%) and Brazilian toll road operator CCR (+0.15%) were the lead performers.

Equatorial Energia (EQTL) is a Brazil-based electric power company which distributes electricity in the northeast states of Para and Maranhão in Brazil. Equatorial reported growing volumes and an encouraging improvement in losses reduction, causing a positive share price reaction.

CPFL Energia is one of Brazil's largest distribution and generation companies, with a 13% market share in distribution and a 3% market share in generation. CPFL's distribution assets include eight separate federally regulated concessions and generation assets consisting of a mix of hydro and renewable assets that are underpinned by long-term take-or-pay contracts. CPFL performed well during the month as preliminary volume and losses data from Brazilian utilities signalled a strong quarter in the midst of a favourable operating environment.

CCR is Brazil's largest public infrastructure concession holder, operating concessions across motorways, urban mobility (sea ferries, subways, light rail) and airports. CCR rebounded during the month following news that the Brazilian toll road regulator set a deadline of December 2022 for Sao Paulo–based toll roads to have their concessions rebalanced after postponing tariffs for the year. Typically, this results in a concession extension.

Turning to Asia Pacific, Indian rail operator Container Corporation of India (+0.45%) also performed well during the month.

Container Corporation of India is India's largest container train operator, with 75% market share. Shares rose as the government made progress on land license fees, which indicates privatisation is close.

Chinese renewables utility China Longyuan Power (-0.49%) was the largest detractor from monthly performance.

China Longyuan Power is the largest wind farm operator in China and one of the largest in the world with over 23 GW of consolidated operational capacity. Shares were down mostly due to a weak outlook for first-half earnings results, which in turn were driven by lower wind speeds. Shares were also dragged down by a market correction in China, especially in growth names.

All returns are in local currency.

Positioning and Outlook

This strategy is invested in high-quality companies benefiting from structural drivers, with strong cash flow and dividend yields. We have strong conviction in the long-term opportunities within emerging markets listed infrastructure. At the regional level, the majority of the strategy is split between Asia Pacific EM (58%) and Latin America (37%). At the sector level, the strategy is split between economically sensitive user-pays infrastructure (54%) and regulated and contracted utilities (42%).

For the **Infrastructure Emerging Markets Strategy**, the primary quantitative tool in portfolio construction is excess return, on which our stock-ranking system is based.

Monthly Stock Highlight

This month we review Philippines-based port operator International Container Terminal Services (ICTS).

ICTS is a port operator that operates terminals through long-term concession agreements with local port authorities and governments.

ICTS has terminals primarily in emerging markets with a primary focus on origin and destination (O&D) cargo. O&D cargoes have higher pricing power when compared to trans-shipment cargoes, so it mainly focuses on maximising the cargo yield as opposed to volumes.

About 51% of total volumes are from Asia, 32% from the Americas and 17% from Europe, the Middle East and Africa (EMEA). Even if ICTS is something of a proxy for EM trade, it has limited exposure to commodities, China, U.S.-China trade tariffs, or other political risks. Its aggregate port utilisation is also only about 56%, and we see ample room for utilisation to increase across its ports.

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