Developed Markets Income Strategy

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Key Takeaways

- Infrastructure assets trailed global equities in the first quarter amid a robust rally for equities, although March saw a reversal as cyclical strength and a slight sentiment shift for utilities helped infrastructure outperform.
- We have been increasing our cyclical exposure through additions in U.S. rails as a restocking cycle should lift rail volumes, while adding selectively to towers and renewables on weakness we believe is transitory.
- We remain constructive on and selective with U.S. utilities, where energy transition and data centre growth remain long-term positive drivers.

Market Overview

Infrastructure assets trailed global equities in the first quarter amid a robust rally for equities, in many ways a continuation of the bull market that began in late 2023 as softening inflation and resilient economic growth spurred risk-on sentiment. Defensive asset classes such as infrastructure outperformed equities in March, however, as cyclical sectors such as energy infrastructure did well and utilities began to get some credit for their long-term drivers, such as surging demand for electricity from AI-powering data centres.

Strong economic and jobs data and the return of the ISM Manufacturing PMI to expansionary territory led to higher energy prices and further solidified the soft landing narrative, helping midstream energy performance in the portfolio for the quarter. GDP-sensitive toll roads and rail also saw positive results. On the flip side, economic strength and the pushing back of potential interest rate cuts weighed on yield-sensitive sectors such as towers and long-duration renewable energy businesses.

Portfolio Highlights

Our global listed infrastructure strategies underperformed infrastructure benchmarks and global equities for the month.

On a regional basis, the U.S. and Canada (+2.06%) was the top contributor for the month, with U.S. electric utilities NextEra Energy (+0.55%) and Southern Company (+0.29%) the lead performers. NextEra Energy (**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 the State of Florida. NextEra's share price rose during the month due to a resolution of the FTC investigation, along with a positive renewables development day.

Southern Company (**Southern**) serves 4.4 million electricity customers in the U.S. Southeast. Southern has over 42,000 MW of generating capacity in Georgia, Alabama, Mississippi and Florida and has some of the best regulatory relationships in the nation. Southern businesses include electric utilities in four states and a growing competitive generation company, as well as fibre optics and wireless communications. Southern outperformed as sentiment towards utilities improved and with the company increasingly being acknowledged as one of the primary beneficiaries in the facilitation of AI data centres.

U.S. communications company Crown Castle (-0.11%) and U.S. rail operator Union Pacific (-0.16%) were the largest detractors. Crown Castle is the leading independent owner and operator of wireless communications infrastructure in the U.S. with a portfolio of approximately 40,000 towers. Shares underperformed as the market favoured more cyclical sectors, while tower stocks, being notably sensitive to interest rates, experienced further declines due to the uptick in bond yields.

Union Pacific is the largest listed railroad company in North America. Union Pacific's share price fell during the month as after a strong start to the year, March volumes were slightly weaker than expected and will be negatively impacted from the Baltimore bridge collapse.

There were no notable changes during the month.

All returns are in local currency.

Positioning and Outlook

We remain defensively positioned as impacts of tightened financial conditions are expected to impact the economy and ultimately corporate earnings. The Fed and many other central banks around the world have moderated in response to the inflation data. Economic data has surprised to the upside this year and defensive sectors such as utilities continue to struggle in this backdrop as a continuation of 2023. However, the exposure to economic sectors such as rail and airports are expected to benefit.