Income Strategy

MONTHLY COMMENTARY | AUGUST 2021

Our global listed infrastructure strategy outperformed infrastructure indices and equities for the month.

Economic activity continued to be robust during the month, despite increasing infections caused by the COVID-19 variant strains. The effectiveness of vaccines in preventing hospitalisations has allowed mobility restrictions to begin to ease globally. Countries with lower vaccination rates, however, have continued to struggle.

Government policy remained supportive, continuing to implement previously announced stimulus. Bond rates stabilised, with real bonds declining, while the view that the inflation spike is largely transitory continued, albeit with risk to the upside. Strong labour and wage data, combined with large increases in commodity prices, highlight the risk of higher inflation. However, significant slack in labour markets is expected to contain inflation risk. Markets performed solidly on the back of strong economic data.

Portfolio Performance

On a regional basis, the U.S. and Canada was the top contributor to monthly performance (+0.89%), of which U.S. renewables utility Clearway Energy (+0.41%) and U.S. electric utility Exelon (+0.28%) were the lead performers.

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 benefitted from the speculation that management may sell Clearway's thermal business, which was then confirmed in the most recent earnings call.

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 rising power prices and potential federal support for nuclear energy.

Turning to Western Europe, U.K. electric utility SSE also performed strongly, contributing +0.40% to monthly performance.

SSE is a diversified energy utility headquartered in Scotland. It is vertically integrated, operating over the entire supply chain in the U.K., with generation (including hydro, wind, CCGT and coal-fired), electricity and gas networks, and retail businesses. It is the U.K.'s largest renewable energy generator. Activist investor Elliott had reportedly built a stake in the company, leading to speculation of a potential breakup.

Canadian energy infrastructure company Pembina Pipeline (-0.25%) was the largest detractor from monthly performance.

Pembina Pipeline provides transportation and midstream services for the energy industry in North America. Sentiment toward the midstream and energy sectors was negatively impacted by the rising COVID-19 Delta variant cases globally, and the perceived impact on global growth.

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 (40%) and consists of exposure to regulated and contracted utilities (30%) and economically sensitive user pays infrastructure (10%).

For the **Global Infrastructure Income Strategy**, the primary quantitative tool in portfolio construction is excess return, on which our stock-ranking system is based. The Global Infrastructure Income Strategy also uses yield quality as a secondary measure. As such, driven by valuation, the Investment Committee initiated a position in U.S. electric utility Entergy.

The strategy also used the opportunity to crystallise some gains by exiting U.S. electric utility Pinnacle West.

Monthly Stock Highlight

This month we review Brazilian electric utility CPFL Energia.

CPFL Energia (CPFE) is a Brazilian integrated electric utility. It is one of Brazil's largest distribution and generation companies, with a 13% market share in distribution and a 3% market share in generation. CPFE's distribution assets include eight separate concessions that are federally regulated and generation assets consisting of a mix of hydro and renewable assets that are underpinned by long-term take-or-pay contracts.

100% of CPFE's value is either regulated or under long-term contracts. As such, CPFE's revenue profile provides investors with stable, inflation-protected cash flows. Additionally, CPFE is privately owned, which reduces their exposure to government pressure.

CPFE's concession areas are concentrated in the richest areas of Brazil (São Paulo, Rio Grande do Sul) and have a clear pathway for growth, having recently concluded tariff reviews across all their major distribution assets. Across their generation business, CPFE remains virtually fully contracted until 2025, leading to a highly stable cash flow profile. CPFE currently trades at an EV/RAB discount relative to their closest peers (Energisa and Equatorial) and we see this gap narrowing as new management continue demonstrate their quality. In light of the recent COVID-19 situation, of all integrated utilities in Brazil, CPFE is best positioned to weather the storm given the contracted nature of their concessions and operations across the most lucrative areas in Brazil, which are less prone to economic downturns.

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