ClearBridge Investments

Developed Markets 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

- Infrastructure indexes and global equities both traded down in October as expectations grew that interest rates would remain higher for longer than previously expected.
- U.K. water companies performed well in October as 2025-2030 business plans were well received and optimism grew that allowed returns would be higher than previously indicated, given higher bond yields.
- We think utilities valuations, like infrastructure broadly, are attractive now, and, versus the more optimistic consensus narrative, our contrarian view is that the risks of a recession remain considerable.

Market Overview

Infrastructure indexes and global equities both traded down in October as expectations grew that interest rates would remain higher for longer than previously expected.

Slowing inflation and reasonably strong economic data have led investors to reassess their expectations of a recession in 2023. China, meanwhile, is experiencing economic challenges as progress in its reopening is being disrupted by difficulties in the Chinese property sector.

Inflation continues to moderate, although concern remains around the level of wage inflation and more recently a surge in oil and gas prices, making it difficult for central banks to loosen policy quickly. As expectations for a higher-for-longer interest rate backdrop gain traction, financial conditions continue to tighten, placing further stress on economic growth. Consensus continues to moderate its expectations for a recession, with the possibility of a recession remaining the largest risk to investors.

Portfolio Highlights

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

On a regional basis, the U.S. and Canada (+1.62%) was the top contributor for October, with U.S. electric utility Public Services Enterprise Group (+0.40%) the lead performer. Public Services Enterprise Group (PEG) operates the largest utility business (~90% of earnings) in New Jersey, along with a generation business (~10% of earnings) comprising nuclear assets. During the month, PEG received a good outcome on the extension of its gas replacement capex program, which came in above the current run rate of investments.

Elsewhere in the region, U.S. communications company American Tower (+0.31%) also performed well. American Tower is a leading independent owner, operator and developer of wireless and broadcast communications infrastructure. The company has 41,000 sites in the U.S. and a further 139,000 sites across 19 countries, predominantly in emerging markets (75,000 in India, 40,000 in Latin America and 18,000 in Africa). Shares did well on the back of stronger than expected results, with management increasing guidance as a result.

Turning to Western Europe, the U.K. water sector recovered after robust regulatory capital value growth ambitions shown in the proposed AMP8 business plans (2025-2030) met with high acceptance by customers, recognising needs for bill increases. This, coupled with more certainty that allowed returns by Ofwat in PR24 would be likely higher than the Final Methodology released last year, given increased bond yields, helped the sector. Additionally, political scrutiny on the sector receded somewhat, with the AMP8 business plans meeting little negative press. U.K. water companies Pennon (+0.47%) and Severn Trent (+0.38%) were among top individual contributors for the month. Severn Trent also benefited from the clearing of an overhang through a successful equity placement.

Australian toll road operator Transurban (-0.23%) and Japanese rail operator West Japan Railway (-0.28%) were the largest detractors. Transurban owns a suite of intra-urban toll road assets that dominate the Australian toll road network in the three state capital cities on the Eastern Seaboard. Additionally, it has several toll roads in North America, predominantly in the Washington D.C. area. Transurban has a high inverse correlation with Australian interest rates and was negatively impacted by the yield increase during the month.

West Japan Railway (JR West) is one of Japan's largest passenger railway operators. JR West operates the Shinkansen high-speed rail lines near Kansai, as well as commuter trains within the Osaka metropolitan network. JR West's share price fell with the large move up in Japanese 10-year bond yields.

All returns are in local currency.

Positioning and Outlook

Despite recent volatility, we are maintaining our defensive positioning as we believe the impacts of tightened financial conditions will eventually affect the economy and ultimately corporate earnings (we are starting to see weakness in earnings from higher interest costs). The Fed and other central banks around the world have to maintain their hawkish position and have started to accept recessionary risks as increasingly likely but necessary to combat the stubbornly high inflation.

Our overarching view is that utilities can handle higher interest rates in the intermediate term. In a slowing growth environment, we believe their predictability of earnings makes utilities attractive compared to general equity sectors where earnings uncertainty results in less confidence among investors and higher volatility.

We think utilities valuations, like infrastructure broadly, are attractive now, and, versus the more optimistic consensus narrative, our contrarian view is that the risks of a recession remain considerable.

Important Information
ClearBridge Investments Limited (ABN 84 119 339 052, AFSL No. 307727) ("ClearBridge") is the Model Manager for the ClearBridge Developed Markets Infrastructure Income Model Portfolio (the "Model Portfolio"). Investors will not be able to invest in the Model Portfolio directly but may only obtain access via a platform, IDPS, IDPS-like or other managed account provider ("Operator"). Any performance reported in this document is the performance of the Model Portfolio and not the performance of any investment option within a scheme. The Operator has full discretion in regard to security selection and composition across portfolio and is responsible at all times for the implementation and ongoing management of any actual investment option based on the Model Portfolio. Each Operator will charge its own fees and costs which will affect the performance of the actual portfolio. This means that the Model Portfolio set out in this document may vary from the actual portfolio held by an Operator. ClearBridge does not have any responsibility to investigate, oversee, review or monitor an Operator's implementation and ongoing management of the Model Portfolio.

This information is not personal advice. It has been prepared without taking account of individual objectives, financial situations or needs. Where an investment product is mentioned, potential investors should seek independent advice as to the suitability of the product to their investment needs. Reference to shares in a particular company, is not a recommendation to buy, sell or hold that stock. Investors should be aware that past performance is not indicative of future performance.

This information may contain forecasts, including in regard to targets, expected returns, PE ratios and dividend yields. Any such statements are based upon research undertaken by the ClearBridge investment team. This research incorporates ClearBridge's reasonable assumptions and beliefs concerning future developments and their potential effect but are subject to risks and uncertainties that may be beyond ClearBridge's control. Returns can be volatile, reflecting rises and falls in the value of underlying investments. Accordingly, ClearBridge does not provide any assurance or guarantee that future developments will be aligned with ClearBridge's expectations, and actual results may differ materially from those expected by ClearBridge at the time of writing.

Issued and approved outside Canada and the United States of America by ClearBridge Investments Limited ("CIL"), registered office Level 13, 35 Clarence Street, Sydney, NSW 2000, Australia (ABN 84 119 339 052; AFSL 307 727).

In Canada and the United States of America, issued and approved by ClearBridge Investments (North America) Pty Ltd ("CINA"), registered office Level 13, 35 Clarence Street, Sydney, NSW 2000, Australia (ACN 138 069 191). Neither CIL nor CINA are registered as a dealer in any province in Canada. CIL and CINA are not offering the securities of any investment fund that may be described in the materials in Canada or the United States. This material has not been approved or verified by the SEC, OSC or the Autorité des marchés financiers.

ClearBridge is wholly, indirectly owned by Franklin Resources, Inc., and part of ClearBridge Investments, LLC.