ClearBridge Investments

The Long-Term Case for Infrastructure

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Key Takeaways

- The U.S. Inflation Reduction Act, signed into law in August, is the most significant climate legislation in U.S. history and we believe this is going to be industry transformative.
- By 2050 the world will be generating at least 2x the electricity in total as today, stressing the need for more power sources and expanded transmission. Adding two electric vehicles to a service territory is the equivalent of adding another house.
- Amid rising bond yields, investors may turn to listed infrastructure, which has historically provided a lower-volatility offering, and should continue to, with efficient market valuations that could be more attractive relative to their unlisted peers.

Energy Security, Climate Are Long-Term Drivers for Infrastructure

Infrastructure remains of heightened interest to investors amid high inflation, slowing growth and a strengthening outlook for infrastructure spending following the passage of the U.S. Inflation Reduction Act. We sat down briefly with Portfolio Manager Nick Langley to get his thoughts on long-term opportunities in the space.

Q: Growth is slowing, inflation is stubbornly high and rates are rising globally. Is it too late for investors contemplating an investment in listed infrastructure?

Nick Langley (NL): No, it is not too late and for several reasons. First, public policy: You always want to invest alongside public policy. Energy security is driving policy right now, and a significant amount of infrastructure will need to be built to attain energy security. High gas prices and supply constraints brought on by the Russia/Ukraine war have highlighted the importance of energy investment and energy security.

Second, fiscal policy. Don't fight fiscal policy. Invest where the government money is going. The U.S. Inflation Reduction Act, signed into law on August 16, 2022, is the most significant climate legislation in U.S. history and we believe this is going to be industry transformative. From an economic perspective there is no reason to build anything other than renewables from now on. Much of this is due to tax credits. Production tax credits for solar/wind are available until 2032 or until a 75% reduction in greenhouse gases is achieved (based off 2022 numbers). Either way, this is expected to be a tailwind for investment for well over a decade.

Third, because of secular growth. The dire need for infrastructure spending underpins growth for the next decade and beyond. President Biden wants to reduce emissions in the U.S. by 50% by 2030, with roughly half of U.S. power coming from solar plants by 2050. It will take nearly $320 billion invested in electricity transmission infrastructure by 2030 to meet net zero by 2050.

Q: Why does so much money need to be invested in infrastructure?

NL: There are several drivers for infrastructure investment, beginning with electrification. By 2050 we'll be generating at least 2x the electricity in total as today, which means we'll need more power sources and expanded transmission. Adding two electric vehicles to a service territory is the equivalent of adding another house. So by 2030 the U.S. needs to extend the transmission network by 60% in terms of gigawatt miles and will need to triple it by 2050 in order to meet net zero.

Overall across the power sector, the International Energy Agency expects that at least $2.5 trillion per annum capital spending needs to be deployed by 2030 in order to reach net zero by 2050.

Q: What do higher bond yields mean for the infrastructure space?

NL: The result for all assets is a higher cost of capital and a higher discount rate, however, most regulated infrastructure companies are kept whole via an increase in allowed returns from regulators. This means the valuations of regulated infrastructure has a long term hedge against changes in bond yields.

About the Author

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- 28 years of investment industry experience
- Joined predecessor organisation in 2006
- Bachelor of Laws and Bachelor of Commerce from the University of Auckland

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