Value Strategy

QUARTERLY COMMENTARY | MARCH 2021

Our Global Listed Infrastructure funds underperformed infrastructure indices, which marginally underperformed equities for the quarter, largely due to higher weights in rate-sensitive stocks among infrastructure sectors.

The quarter saw rapid increases in both bond rates and inflation expectations as the economic recovery continued, strongly aided by a quickening vaccine rollout and massive levels of government stimulus. Consensus growth expectations were revised higher during the quarter. Inflation is expected to increase in the coming months due to transitory effects before returning to a more normalised rate. Bond rates are expected to increase in a more orderly path for the remainder of 2021 before settling around 2.0%–2.5% for the U.S. 10-year Treasury note.

Vaccine rollouts continued to accelerate in many regions, driving optimism about reductions in mobility restrictions, despite increasing COVID-19 cases in regions such as Europe. Reductions in mobility restrictions are expected to impact the second half of 2021 and are required for the recovery of the services sector, which lags the largely recovered goods sector. This will likely drive further increases in revenues for transport assets.

Stimulus remained plentiful, particularly in the U.S. with Biden's $1.9 trillion stimulus plan approved during the quarter and closely followed by a proposal for a $2 trillion infrastructure bill, broadly defined. Strong levels of stimulus will continue to support economic growth.

Portfolio Performance

On a regional basis, North America was the top contributor to quarterly performance (+2.14%), of which U.S. energy infrastructure company Cheniere Energy (+0.88%) and Canadian energy infrastructure company Enbridge (+0.42%) were the lead performers.

Cheniere Energy is an energy infrastructure company that owns and operates U.S. liquefied natural gas (LNG) export facilities. Cheniere delivered a strong fourth quarter that resulted in upgrades to the company's forward 2021 guidance. Cheniere should benefit from an Improving LNG contracting environment following the strong cyclical recovery.

Enbridge owns and operates one of the largest oil and gas pipeline networks in North America. The company also owns regulated gas distribution utilities in Ontario, Canada. Energy stocks were in favour during the first quarter, as they are viewed as beneficiaries of the eventual economic recovery, as COVID-19 vaccines get rolled out through 2021. Enbridge has already experienced substantial recovery in its oil throughput in their pipeline systems, and is expected to fully recover by year-end as refinery demand normalises.

Elsewhere in the region, U.S. rail operator Union Pacific (+0.33%) also performed well.

Union Pacific is the largest listed railroad company in North America. Despite impacts from the polar vortex, Union Pacific was the beneficiary of a market shift into high-beta stocks, further bolstered by Biden's stimulus package and potential infrastructure bill.

In Western Europe, French toll road operator Vinci performed strongly, contributing +0.32% to quarterly performance.

Vinci operates half of France's toll road network under long-term concession agreements, a portfolio of airport concessions and a global contracting business. Vinci's toll roads and contracting earnings is expected to substantially recover to pre-covid levels by year-end, while its Airports business will take longer to recover.

Danish renewables utility Orsted (-0.89%) was the largest detractor from quarterly performance.

Orsted is the global industry leader in the offshore wind industry, with about 30% market share. Over the past few years, Orsted has gradually exited its fossil fuel activities and more recently its energy distribution and retail business, transforming itself into a green solutions provider. It is a pure play in renewables with over 90% of its earnings from regulated and

contracted activities in 2019–25. A green recovery in the EU with a hydrogen strategy to combat climate change should be long-term drivers for Orsted. Shares saw weakness driven mainly by a global renewables selloff, due to a market rotation out of 'growth' sectors into 'value' sectors, as well as increasing competition concerns in the Offshore wind industry with Oil majors continuing to aggressively bid for projects.

All returns are in local currency.

Positioning and Outlook

On a regional level, the Strategy's largest exposure is in the U.S. & Canada (55%) and consists of exposure to regulated and contracted utilities (34%) and economically sensitive user pays infrastructure (21%).

For the **Global Infrastructure Value Strategy**, the primary quantitative tool in portfolio construction is excess return, on which our stock-ranking system is based. As such, driven by valuation, the Investment Committee initiated positions in U.S. electric utility Alliant Energy, French toll road operator Eiffage, Japanese rail operator East Japan Railway and Canadian energy infrastructure company Pembina Pipeline.

The fund exited Italian gas utility Snam, U.S. electric utility Edison International and Danish renewables utility Orsted to use as funding sources.

Quarterly Stock Highlight

This quarter we review U.S. renewables utility NextEra Energy Partners (NEP).

NEP is a growth-oriented contracted renewables company formed by its sponsor and general partner NextEra Energy (NEE) to own, operate and acquire contracted renewable energy generation assets located in North America. NEP's portfolio consists of wind, solar and natural gas pipeline assets. The weighted average contract duration is approximately 20 years.

NEP is a premium U.S. YieldCo. The sheer size of its dropdown assets relative to its starting size means the duration and magnitude of its growth story is unmatched among peers. Growth comes from the dropdown of assets from NEE and we anticipate this should allow NEP to provide 12%–15% dividend growth to 2024.

With NEP warehousing completed and operational contracted assets from NEE, NEP should command a higher valuation and lower cost of capital than its parent, allowing accretive dropdown transactions to be made between the YieldCo and the parent.

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