ClearBridge
A Franklin Templeton Company

Emerging Markets Strategy

Charles Hamieh
Managing Director, Portfolio Manager

Shane Hurst
Managing Director, Portfolio Manager

Nick Langley
Managing Director, Portfolio Manager

David Pow
Director, Portfolio Manager

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.
- On a regional basis, Asia Pacific was the top contributor for the quarter, led by GDP-sensitive port and airport holdings.
- We remain defensively positioned as impacts of tightened financial conditions are expected to impact the economy and ultimately corporate earnings.

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 some of 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 Performance

The ClearBridge Emerging Markets Strategy outperformed infrastructure benchmarks but were outpaced by global equities for the quarter.

On a regional basis, Asia Pacific (+6.00%) was the top contributor for the quarter, with Philippines-based port operator International Container Terminal Services (+1.35%) and Malaysian airport operator Malaysia Airports (+0.92%) the lead performers. International Container Terminal Services (**ICTS**) operates terminals through long-term concession agreements with local port authorities and governments. ICTS rallied with the continued strength in yield and volumes momentum, coupled with a strong set of fourth-quarter results.

Malaysia Airports is one of the world's largest airport operators by passenger numbers. Based in Kuala Lumpur, it operates all but one airport in Malaysia and also has a 100% stake in Istanbul's Sabiha Gokcen airport. Improvements in the airport passenger service charge framework and constructive volumes both helped boost Malaysia Airports share price.

Brazilian electric utility Equatorial Energia (-0.50%) and Brazilian toll road operator EcoRodovias (-0.38%) were the largest detractors for the quarter. Equatorial Energia (**EQTL**) is a Brazil-based electric power company that distributes electricity in the Northeast states of Para and Maranhão in Brazil. EQTL was weaker during the quarter as blackouts across the country caused by the hot and windy weather led the government to postpone distribution concession renewals affecting the entire sector. Going forward, the government is looking to add additional terms, which may include more stringent service requirements in the case of future blackouts.

EcoRodovias (**ECOR**) is one of the largest toll road companies in Brazil. Despite reporting strong quarterly results and favourable traffic figures, ECOR was down for the quarter as the Brazilian market has been weak to start the year, resulting in muted share price performance for high-beta stocks like ECOR.

During the quarter, we initiated positions in Brazilian electric utility Sabesp, Chinese electric utility China National Nuclear Power, Chinese airport operator Guangzhou Baiyun International Airport and Korean electric utility Korea Electric Power. We also used the opportunity to crystallise some gains by exiting our positions in Chinese renewables utility China Longyuan Power and Brazilian electric utility Auren Energia.

All returns are in local currency.

Positioning & 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. However, economic data has surprised to the upside this year and defensive sectors such as utilities continue struggle in this backdrop as a continuation of 2023. As a result, we are reviewing our positioning and increasing our cyclical exposure where it makes sense.