ClearBridge Investments

Global Infrastructure Income Strategy

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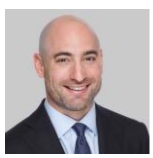

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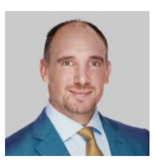

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Key Takeaways

- Stimulus, easy monetary policy, expectations of bond rates remaining low and positive news flow around vaccine development all combined to support financial markets.
- The global commitment to decarbonization gained further momentum, helping renewables make strong contributions to the Strategy.
- Regardless of the result of the U.S. election, we continue to see the need for infrastructure spending as a tool to recover from the pandemic.

Market Overview and Outlook: Lower Emissions Are Meaning Higher Returns

General equities performed strongly during the quarter, supported by ongoing policy stimulus and an improved economic outlook. Economic data continued to show signs of a strong rebound from the COVID-19-induced lows of the second quarter, albeit the rebound moderated. The Strategy trailed equities for the period but advanced well ahead of its S&P Global Infrastructure benchmark.

COVID-19 infections continued to spread in many regions, resulting in targeted changes to mobility restrictions, particularly in the U.S. and emerging markets and more recently Europe. As such, market expectations for a V-shaped economic recovery tempered during the quarter. Government stimulus was further extended in many regions, including the landmark European Recovery Fund. Stimulus, easy monetary policy, expectations of bond rates remaining low for a significant period and positive news flow around vaccine development all combined to support financial markets. Concerns continued around rising inflation risk given monetary policy; this risk, however, is offset by the significant slack in global economies.

Political relations, particularly related to China, continued to deteriorate, while Joe Biden remained the favorite to win the U.S. presidential election. The global commitment to decarbonization gained further momentum with Biden's proposed climate change policies, Europe's enhanced carbon reduction target of 55% by 2030 and China's pledge of net-zero emissions by 2060.

Within the infrastructure benchmark, more defensive utilities such as water (+5.80%) and electric (+5.39%) led the way as their strong income components looked attractive in a low interest rate environment, followed by airports (+5.34%) as they rebounded after near halts to activity due to the pandemic. The energy infrastructure sector remained challenged (-5.93%) amid low commodity prices and a darker demand outlook as COVID-19 has reduced economic activity.

On a regional basis, Asia Pacific Developed continued to lead the benchmark (+3.65%), followed by Latin America (+2.93%), while Asia Pacific Developing (-1.36%) was the only region in the red.

> Inflation risk is fairly offset by the significant slack in global economies.

Within the portfolio, the U.S. & Canada was the top regional contributor to quarterly performance, of which Canadian renewables utility Brookfield Renewable, U.S. renewables utility NextEra Energy Partners and Clearway Energy were the lead performers.

Brookfield Renewable is a pure-play renewables operator and developer headquartered in Canada, focused on international hydro, solar, wind and storage technology. Markets have been coming around to the broader renewables theme and recognizing the company as a leader in the space. Additionally, Brookfield's investor day was well-received, with the company providing clarity for double-digit funds from operations growth through 2025.

NextEra Energy Partners (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. Growth comes from dropdown, i.e., purchasing, of assets from NEE and we anticipate this should allow NEP to provide 12% – 15% annual dividend growth to 2024. NEP did well due to the improved probability of Biden winning the U.S. presidential election. If he is elected, the outlook for renewables growth improves further.

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. Investors have been constructive on growth initiatives Clearway announced earlier this year.

Turning to Asia Pacific, Australian electric utility AusNet Services (AST) also performed well. AST owns and operates energy infrastructure in Australia, including the electricity transmission network in Victoria, an electricity distribution network that delivers electricity to over 720,000 consumer connection points in Eastern Victoria and a gas distribution network that delivers natural gas to about 700,000 consumer connection points in Central and Western Victoria. AusNet's share price increased during the quarter as the market began to appreciate its cost efficiency and transmission capex opportunities, and the stock recovered following a period of weakness after it rebased its dividend in May 2020.

Chilean water company Aguas Andinas was the largest detractor from quarterly performance. Aguas Andinas supplies drinking water and provides sewerage and treatment services to residential, commercial and industrial customers in Chile. Volumes taking a hit due to the pandemic made for a difficult quarter, while Chile is in the midst of its worst drought ever. This has had a negative impact on Aguas's EBITDA margins, adversely affecting water purchase costs.

Portfolio Positioning

On a regional level, the Strategy's largest exposure over the quarter was in the U.S. & Canada (36%), consisting of exposure to utilities (34%) and economically sensitive sectors (2%).

The U.S. election is front and center and is factoring into our detailed scenario analysis of possible outcomes. Regardless of the result, we continue to see the need for infrastructure spending as a tool to recover from the pandemic, whether it is in traditional infrastructure — highways, rail, public transport — or infrastructure considered green and focused on reducing greenhouse gas emissions. Utilities with renewable energy assets and greener modes of transportation such as rail should benefit from long-term policy support in either scenario, though green infrastructure spending seems like it will be larger under a Biden administration. In that scenario, midstream infrastructure should face some challenges through increased regulation and potential changes to tax structures. Independent of the election, midstream is an area of the portfolio we have reduced in recent quarters as we manage risks of the world transitioning to more sustainable energy; we are confident our renewables exposure and our attention to green infrastructure will see multidecade support.

Telecommunication towers, which represent our economically sensitive exposure in North America, are fairly neutral to the election. Biden's proposed $80 billion initiative to roll out broadband to rural areas could be a marginal positive for tower companies if they can participate.

Portfolio Highlights

We believe an absolute return, inflation-linked benchmark is the most appropriate primary measure against which to evaluate the long-term performance of our infrastructure strategies. The approach ensures the focus of portfolio construction remains on delivering consistent absolute real returns over the long term.

On an absolute basis, the Strategy delivered gains across the seven of nine sectors in which it was invested (out of 11 total) in the third quarter, with the renewables and electric sectors the leading contributor and the water sector the only significant detractor.

On a relative basis, measured against the S&P Global Infrastructure Index, the ClearBridge Global Infrastructure Income Strategy outperformed during the third quarter. Overall sector allocation contributed to performance, in particular a large overweight to the renewables sector. Stock selection in the gas and energy infrastructure sectors was also beneficial. Conversely, stock selection in the water and electric sectors and an underweight to the airports sector detracted from relative results. On a regional basis, stock selection in the U.S. & Canada and an overweight to Asia Pacific Developed had the most positive impacts, while stock selection in Latin America was detrimental.

On an individual stock basis, the largest contributors to absolute returns in the quarter included Brookfield Renewable, NextEra Energy Partners LP, Clearway Energy, Terraform Power and AusNet Services. The primary detractors from absolute returns were positions in Aguas Andinas, National Grid, Enagas, Atlas Arteria and SSE.

During the quarter, besides names discussed above, we initiated new positions in U.S. electric utilities Public Service Enterprise and Southern Company and took the opportunity to crystallize some gains by exiting positions in U.S. electric utility CenterPoint Energy and Canadian electric utility Hydro One, Chinese port operator China Merchants Port Holdings and U.K. water company Pennon. U.S. renewables company TerraForm Power was acquired by Brookfield Renewable during the quarter and the portfolio's shares of TerraForm Power were converted to those of Brookfield Renewable.