ClearBridge Investments

Global Infrastructure Value Strategy

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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: Infrastructure Spending will Help Fuel Recovery

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.

In the portfolio, the U.S. & Canada was the top regional contributor to quarterly performance, of which Canadian renewables utility Brookfield Renewable, U.S. rail company Union Pacific and U.S. electric utility Public Service Enterprise Group 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.

Union Pacific (UNP) is the largest listed railroad company in North America. UNP's freight transportation services are crucial to the functioning of the U.S. economy. Investors welcomed UNP's continued volume recovery, which has been comfortably above initial expectations. UNP has demonstrated strong cost controls amid carloads, which were impacted by the pandemic.

Public Service Enterprise Group (PEG) is a U.S. diversified energy company. PEG's revenues are regulated by its respective state utility commissions and its electric transmission assets are regulated by the Federal Energy Regulatory Commission (FERC). PEG announced a strategic review of its gas assets, potentially improving the ESG profile of the company (no more fossil assets) and allowing for a business mix akin to some of the premium regulated utilities in the space. Additionally, PEG received a constructive outcome on its energy efficiency filing, receiving 80% of its ask over a three-year period (locking in regulatory asset base growth of 7%–8% through to 2024).

Turning to Western Europe, Danish renewables utility Orsted also performed well. 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 oil, coal and gas businesses. More recently it has exited the energy retail business and transformed this business 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. Shares were higher on positive sentiment around renewables, supported by news from the EU on green recovery and a hydrogen strategy to combat climate change.

French toll road operator Vinci was the largest detractor from quarterly performance. Vinci operates half of France's toll road network under long-term concession agreements, a growing portfolio of airport concessions, and a global contracting business. A rise in COVID-19 cases in Europe during the quarter caused concerns around the outlook for traffic recovery, pressuring Vinci's stock.

Portfolio Positioning

On a regional level, the Strategy's largest exposure over the quarter was in the U.S. & Canada (53%), consisting of exposure to utilities (~41%) and economically sensitive sectors (~11%).

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 five of nine sectors in which it was invested (out of 11 total) in the third quarter, with the renewables and electric sectors the leading contributors and the toll roads sector the main detractor.

On a relative basis, measured against the S&P Global Infrastructure Index, the ClearBridge Global Infrastructure Value Strategy outperformed the benchmark during the third quarter. Overall sector allocation contributed to performance, in particular a large overweight to the renewables sector. Stock selection in the rail and gas sectors was also beneficial. Conversely, stock selection in the water, electric and toll roads sectors, an overweight to the rail sector and an underweight to the airports sector detracted from relative results. On a regional basis, stock selection in the U.S. & Canada had the most positive impact, while stock selection in Western Europe was detrimental.

On an individual stock basis, the largest contributors to absolute returns in the quarter included Brookfield Renewable, Union Pacific, Orsted, Public Service Enterprise and Terraform Power. The primary detractors from absolute returns were positions in Vinci, Ferrovial, Getlink, American Tower and Cheniere Energy.

During the quarter, besides names discussed above, we initiated a new position in Portuguese renewables utility Energias de Portugal. We also took the opportunity to crystallize some gains by exiting positions in U.S. electric utility CenterPoint Energy, New Zealand airport operator Auckland International Airport and U.K. water company United Utilities. 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.