ClearBridge Investments

Global Infrastructure Income Strategy

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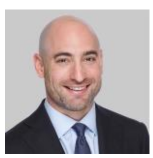

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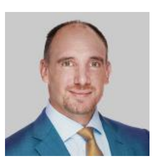

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Key Takeaways

- Infrastructure underperformed equities for the quarter, largely due to higher weights in rate-sensitive stocks among infrastructure sectors.
- On a regional basis, North America was the top contributor to quarterly performance.
- Looking ahead, we are constructive on a global recovery and see clear drivers for economically sensitive user pays assets as mobility increases, policy support for renewables as well as key catalysts for U.S. utilities, whose valuations look attractive.

Market Overview and Outlook

The Strategy underperformed infrastructure indexes, which 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 normalized 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. Improved mobility is expected to impact the second half of 2021 and is required for the recovery of the services sector, which lags the largely recovered goods sector. This will drive further increases in revenues for transport assets.

Stimulus remained plentiful, particularly in the U.S. with the Biden Administration'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.

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We have found there is actually little correlation between infrastructure and utility performance versus inflation.

Portfolio Performance

On a regional basis, North America was the top contributor to quarterly performance, of which Canadian energy infrastructure company Enbridge and U.S. renewables utility NextEra Energy Partners (NEP) were the lead performers.

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. The first quarter saw the market giving the energy sector credit for its leverage to the eventual economic recovery as COVID-19 vaccines get rolled out through 2021.

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 the dropdown of assets from NEE and we anticipate this should allow NEP to provide 12%–15% dividend growth to 2024. Shares were higher amid an improved renewables project backlog following fourth-quarter results. Continued positive green policy news following the Democrats' runoff election wins also raised expectations of green fiscal stimulus.

Elsewhere in the region, U.S. energy infrastructure company Williams Companies also performed well. Williams owns and operates natural gas pipelines and associated midstream assets in the U.S. Shares continued to rebound driven by the strong cyclical recovery, which has benefited energy stocks. Williams also delivered resilient fourth-quarter earnings despite energy demand pressure from COVID-19.

Spanish electric utility Red Electrica was the largest detractor from performance. Red Electrica operates the national electricity grid in Spain and holds assets in Portugal, Peru and Bolivia. The company delivered underwhelming capex guidance, leading to market concern about its forward dividend. We reduced our exposure during the period.

U.S. renewables utility Brookfield Renewable was another detractor. Brookfield Renewable is a pure-play renewables operator and developer headquartered in Canada and domiciled in the U.S., focused on international hydro, solar, wind and storage technology. As more private and public institutions announce ambitious carbon reduction initiatives, Brookfield Renewable's globally diversified, multi-technology renewables business makes it an attractive partner. Its development pipeline stands at 18,000 megawatts, providing confidence the company can meet its targeted double-digit cash flow growth through to 2025. Shares moderated amid expectations of rising bond yields, and a cool-off on the green trade.

Positioning and Outlook

On a regional level, the Strategy's largest average exposure was in the U.S. & Canada (37%) and consisted of exposure to regulated and contracted utilities (31%) and economically sensitive user pays infrastructure (6%).

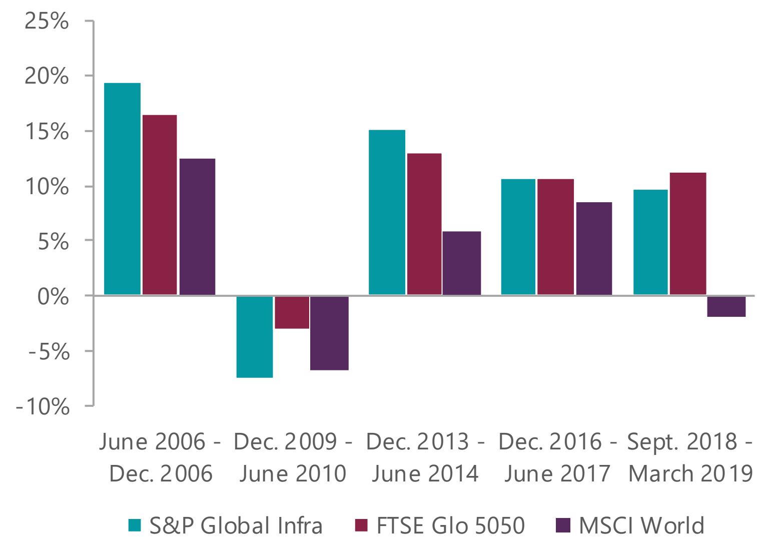
During the quarter we initiated positions in French toll road operators Vinci and Eiffage, U.S. electric utility Pinnacle West, Brazilian toll road operator CCR, Spanish toll road operator Ferrovial, U.S. infrastructure company Brookfield Infrastructure, Canadian energy infrastructure company Pembina Pipeline, Brazilian electric utility CPFL Energia and French rail operator Getlink.

We closed positions in Australian gas utility APA Group, U.S. energy infrastructure company Williams Companies, U.K. water utility United Utilities, Brazilian electric utility CTEEP, U.S. electric utility Edison International and Italian electric utility Terna.

Looking ahead, we are constructive on a global recovery. Vaccination progress and mobility improvements will benefit road, rail and airport exposures, as well as midstream/energy infrastructure as GDP increases. U.S. utilities remain very attractive from a valuation standpoint, with some companies having very key catalysts to play out over the next quarter. Decarbonization, which has growing policy drivers, permeates the entire portfolio in various forms, most directly through contracted renewables. Communications Towers will benefit from the 5G rollout, which is starting to see momentum building following the completion of the recent C-Band auctions and master lease agreements and amendments with carrier customers such as Verizon.

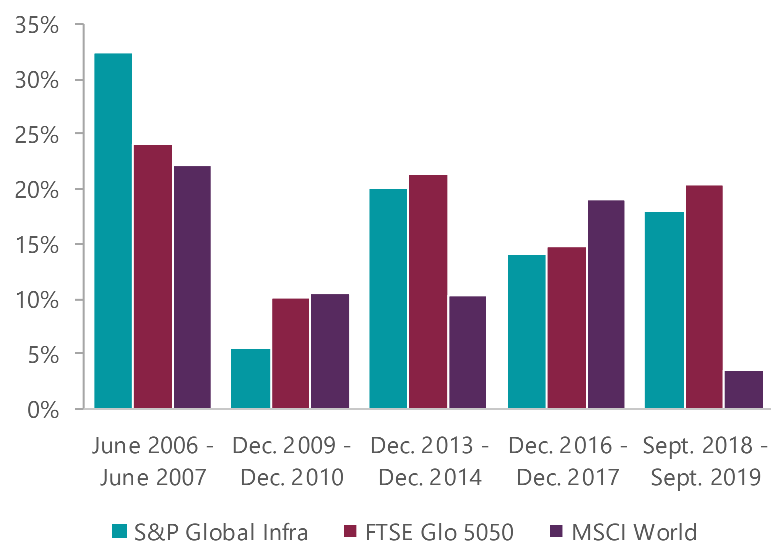
Global bond yields were up in the quarter in the U.S., Australia and Europe, begging the question of what happens to infrastructure with higher inflation. Given the large amount of stimulus put through by President Biden, and more expected in the U.S. and globally, we think there will be some type of cyclical inflation. But, in the longer term, our view is still structural. Inflation remains around 2%. This ends up not meaning much for utilities and infrastructure: inflation gets passed through in the case of utilities through their cost of capital, while user pays infrastructure assets with concessions, contracts, tariffs and tolls end up passing through inflation as well. We have found there is actually little correlation between infrastructure and utility performance versus inflation. Moreover, looking at the last 30 years, those periods of strongly rising bond yields have been the best periods to position the portfolio and have led to strong returns for infrastructure assets in the subsequent periods (Exhibits 1–3).

Exhibit 1: Infrastructure Performance After Rise in Yields: 6 Months



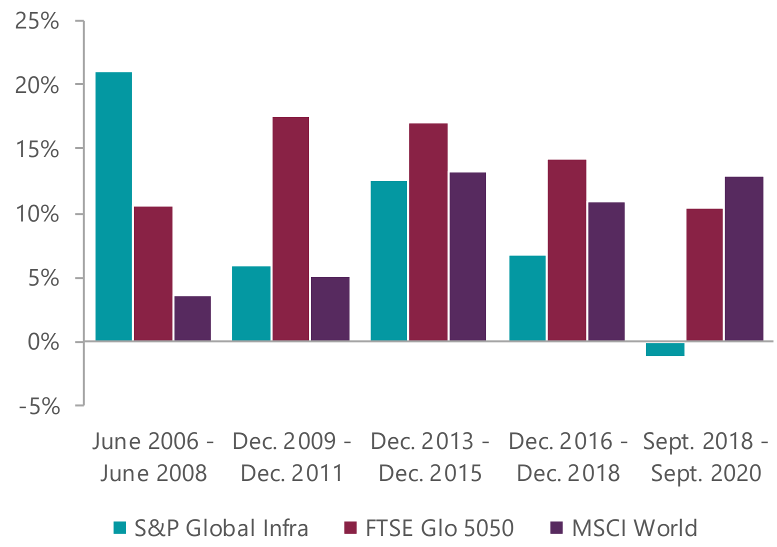
Source: ClearBridge Investments, Bloomberg Finance.

Exhibit 2: Infrastructure Performance After Rise in Yields: 12 Months



Source: ClearBridge Investments, Bloomberg Finance.

Exhibit 3: Infrastructure Performance After Rise in Yields: 24 Months



Source: ClearBridge Investments, Bloomberg Finance.

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 four of the 10 sectors in which it was invested (out of 11 total) in the first quarter, with the gas and energy infrastructure sectors the leading contributors and the renewables and electric sectors the main detractors.

On a relative basis, measured against the S&P Global Infrastructure Index, the ClearBridge Global Infrastructure Income Strategy underperformed during the first quarter. Overall sector allocation detracted from performance, in particular a large overweight to the renewables sector and an underweight to the energy infrastructure sector. Stock selection in the gas and electric sectors also weighed on relative results. Meanwhile, stock selection in the renewables sector and an underweight to the airports sector proved beneficial.

On a regional basis, the U.S. and Canada region was the strongest contributor, while Western Europe was the main detractor.

On an individual stock basis, the largest contributors to absolute returns in the quarter included Enbridge, NextEra Energy Partners LP, TC Energy, Williams Companies and Exelon. The primary detractors from absolute returns were positions in Red Electrica, Brookfield Renewable, Clearway Energy, Atlas Arteria and EDP-Energias De Portugal.