



## Global Infrastructure Income Strategy



**Daniel Chu CFA**  
Director,  
Portfolio Manager



**Charles Hamieh**  
Managing Director,  
Portfolio Manager



**Shane Hurst**  
Managing Director,  
Portfolio Manager



**Nick Langley**  
Managing Director,  
Portfolio Manager

### Key Takeaways

- ▶ Listed infrastructure outpaced global equities in the third quarter as a growth scare, coupled with high valuations for AI-related tech stocks, catalyzed a market rotation to a mixture of defensive, commodity- and rate-sensitive securities.
- ▶ A 50 basis point cut to the U.S. federal-funds rate also helped defensive and yield-oriented sectors such as communication towers, the Strategy's leading sector in terms of absolute returns.
- ▶ While market breadth has improved since the start of the year, with the Strategy outperforming global equities since the end of February, we still don't think the strong themes driving infrastructure are getting sufficient recognition by the market and believe it is only a matter of time before fundamentals become more fully reflected in market pricing.

### Market Overview

Listed infrastructure outpaced global equities in the third quarter as a growth scare, coupled with high valuations for AI-related tech stocks, catalyzed a market rotation to a mixture of defensive, commodity- and rate-sensitive securities. Signs of slowing growth also raised hopes for an interest rate cut in the U.S., and the Federal Reserve delivered with a larger-than-expected 50 basis point cut to the federal-funds rate in September. The S&P Global Infrastructure Index gained 13% for the quarter, handily outpacing the MSCI World Index's 6% gain (both in U.S. dollars).

The rotation toward a risk-off market sentiment, driven by a combination of weak economic data from Europe, disappointing technology-related earnings results, softer than expected job reports from the U.S. and an interest rate hike by the Bank of Japan, helped showcase the defensive nature of infrastructure, which should continue to receive a tailwind from further interest rate cuts in the quarters ahead.

The rate cut in the U.S. was positive for a range of infrastructure sectors, with electric, water and gas utilities performing well, along with longer-duration communication towers and renewables. More economically sensitive sectors made solid gains but trailed the group, as airports, rails and toll roads coped with concerns of slowing economic activity, while lower oil prices, due to rising inventory levels in the U.S. and lackluster demand from China, weighed on energy infrastructure.

For the quarter, the ClearBridge Global Infrastructure Income Strategy outperformed USD-denominated global equities and infrastructure benchmarks, as measured by the MSCI World Index and the S&P Global Infrastructure Index, respectively. Performance was supported by U.S. and European electric utilities and U.S. communication towers.

On a regional basis, the U.S. and Canada was the top contributor for quarter, with U.S. electric utility Entergy and U.S. communications company Crown Castle the lead performers. Entergy is a regulated electric utility, providing services to approximately three million people in Arkansas, Louisiana, Texas, Mississippi and New Orleans. Entergy's share price rallied in the quarter due to a solid storm response, with hurricane activity also bolstering the need for further resiliency investment. Crown Castle is the leading independent owner and operator of wireless communications infrastructure in the U.S. with a portfolio of approximately 40,000 towers. Shares of Crown Castle outperformed as the market favored more defensive sectors, while tower stocks, being notably sensitive to interest rates, experienced additional benefit due to the decline in bond yields.

Meanwhile, Canadian energy infrastructure company Gibson Energy and Australian toll road operator Atlas Arteria were the largest detractors.

Gibson Energy is an oil midstream logistics provider in Western Canada and the U.S. Gibson's share price fell with general market movement. Fundamentals remained strong, however, with Gibson's recently acquired South Texas Gateway assets continuing to outperform management's bid assumptions and management announcing a contract extension with a key customer. Gibson's legacy oil storage assets in Western Canada continued to provide stable contracted cash flows, while management continued to explore further expansion projects with customers.

Atlas Arteria's key assets consist of a 31% stake in French toll roads concessions of operators APRR, AREA and ADELAC, as well as U.S. toll roads concession ownership consisting of 66.7% of the Chicago Skyway and 100% of the Dulles Greenway in Virginia. In addition, it owns the Warnow Tunnel in Germany. On a proportionate enterprise value basis, the French toll roads represent approximately 60% of value, the Chicago Skyway 20% and the Dulles Greenway 15%. Atlas Arteria was weak after the company failed to reach an outcome with the state of Virginia. Additionally, French companies lost their appeal in the context of the government's new concession tax, which led to a drag on earnings.

## Outlook

We continue to view infrastructure fundamentals as very strong — not only are inflation pass-throughs operating as expected, but there are also several strong long-term supportive themes, including decarbonization, significant network investment, supply chain realignment and powering AI/data centers. We are expecting bond

volatility to reduce and market breadth to continue to broaden — as that occurs, we expect that the market will increasingly recognize the strong fundamentals and long-term themes of infrastructure.

Given the prospect of slowing growth from elevated levels, it's not surprising to see equity market volatility. In this environment, we believe infrastructure's defensive qualities and downside protection will become more apparent. In a slowing growth environment, we believe that this predictability of earnings makes regulated utilities (the bulk of the portfolio) attractive. Further, we continue to see positive earnings revisions for regulated and contracted utilities, based on that pass-through of inflation and on the growth in their underlying asset bases.

In terms of positioning, we maintain greater exposure to regulated and contracted utilities and continue to pivot toward high growth utilities. These are utilities with exposures to the strong themes of infrastructure and a significant backlog of projects that will drive their asset base growth, and in turn, earnings growth for shareholders. These high-growth utilities also have the added benefit of having a high likelihood of upside earnings surprises.

While market breadth has improved since the start of the year, with the Strategy outperforming global equities since the end of February, we still don't think the strong drivers of infrastructure are getting sufficient recognition by the market and believe it is only a matter of time before the fundamentals start to be increasingly reflected in market pricing.

### **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 saw positive contributions from all nine sectors in which it was invested in the quarter, with the electric utility and communications sectors the main positive contributors.

Relative to the S&P Global Infrastructure Index and on a U.S. dollar basis, the Strategy outperformed in the third quarter, driven primarily by stock selection in the renewables sector as well as an underweight to airports and overweights to communications, electric utilities and water utilities. Conversely, stock selection in the water utilities sector and a renewables overweight detracted.

On an individual stock basis, the top contributors to absolute returns in the quarter were Entergy, Crown Castle, NextEra Energy, American Tower and Constellation Energy. The sole detractors were Gibson Energy and Atlas Arteria, while NextEra Energy Partners LP, United Utilities and Italgas underperformed.

During the quarter, we initiated positions in Canadian electric utility Emera, Spanish airport operator AENA, U.S. electric utility WEC Energy, U.S. energy infrastructure company Williams Companies and Italian gas utility Italgas. We also exited our positions in U.K. water company United Utilities, Chinese gas utility China Resources Gas, Spanish toll road operator Ferrovial and U.S. electric utility Southern Company.

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