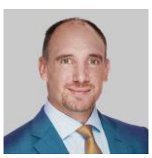
ClearBridge
A Franklin Templeton Company

# Global Infrastructure Value Strategy

**Charles Hamieh**
Managing Director,
Portfolio Manager

**Shane Hurst**
Managing Director,
Portfolio Manager



**Nick Langley**
Managing Director,
Portfolio Manager

**Simon Ong**
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 longer-duration renewables, the Strategy's leading sector in terms of absolute returns.
- Given the prospect of slowing growth from elevated levels as well as declining interest rates, we believe the defensive and income-producing qualities of infrastructure will continue to become more apparent, as was evident in the third quarter.

## 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 reduction 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, on a local currency basis the ClearBridge Global Infrastructure Value Strategy outperformed USD-denominated global equities and trailed infrastructure benchmarks, as measured by the

MSCI World Index and the S&P Global Infrastructure Index. 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 utilities Entergy and NextEra Energy 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. NextEra Energy is an integrated utility business with a regulated utility operating in Florida and the largest wind business in the U.S. NextEra's regulated business, including Florida Power & Light, serves nine million people in the State of Florida. Shares were higher amid a market rotation to defensive utilities and were further aided by a cut in U.S. interest rates, which were beneficial for NextEra's longer-duration renewables assets.

Meanwhile, Canadian energy infrastructure company Gibson Energy and U.S. electric utility CenterPoint Energy 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.

CenterPoint Energy is an electric and natural gas utility serving seven million customers in eight states across the U.S. The majority of operations are in Houston, Texas. CenterPoint's shares were hit due to increased regulatory/political risk in Texas following a subsidiary's poor performance during Hurricane Beryl in early July. While it might take some time to improve the utility's reputation in the state and resolve regulatory issues (with likely insignificant financial impact), the fundamentals of the business remain healthy. Texas continues to see strong electric load growth and infrastructure investment needs are high. The state's regulatory backdrop remains favorable, and we view shares as unsustainably discounted.

## 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 decline 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 exposure 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 keeping pace with 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 fundamentals become more fully 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 third quarter, with the electric utilities 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, airports and toll roads underweights and overweights to the communications, water utilities and electric utilities sectors. Conversely, stock selection in the electric utilities, energy infrastructure and rail sectors, overweights to rail and renewables sectors and an underweight to gas utilities detracted.

On an individual stock basis, the top contributors to absolute returns in the quarter were Entergy, NextEra Energy, Constellation Energy, American Tower and Dominion Energy. The main detractors were Gibson Energy, CenterPoint Energy, Canadian National Railway and Rumo, while Aeroports De Paris also lagged.

During the quarter, we initiated positions in Canadian energy infrastructure company TC Energy, Canadian electric utility Emera, Spanish airport operator AENA, U.S. electric utility WEC Energy, U.S. electric utility DTE Energy, U.S. energy infrastructure company Williams Companies and Canadian rail operator Canadian National Railway. We also exited our positions in Brazilian water company Sabesp, Brazilian electric utility Equatorial Energia, U.S. rail operator Norfolk Southern, Canadian energy infrastructure company Gibson Energy, Danish renewables utility Orsted and U.S. electric utility Public Services Enterprise Group.