ClearBridge
A Franklin Templeton Company

Global Infrastructure Value Strategy

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Key Takeaways

- Infrastructure delivered positive returns in the first quarter, outpacing both global equities and U.S. equities, which were weaker amid higher policy uncertainty, specifically around tariffs.
- Infrastructure's defensive nature was rewarded in this environment, with regulated utilities leading returns, in particular in Europe and North America.
- Trump's policy agenda has so far been more disruptive than expected, and we anticipate uncertainty will weigh on U.S. growth. However, other regions such as Europe may see improving growth through a potentially constructive fiscal agenda.

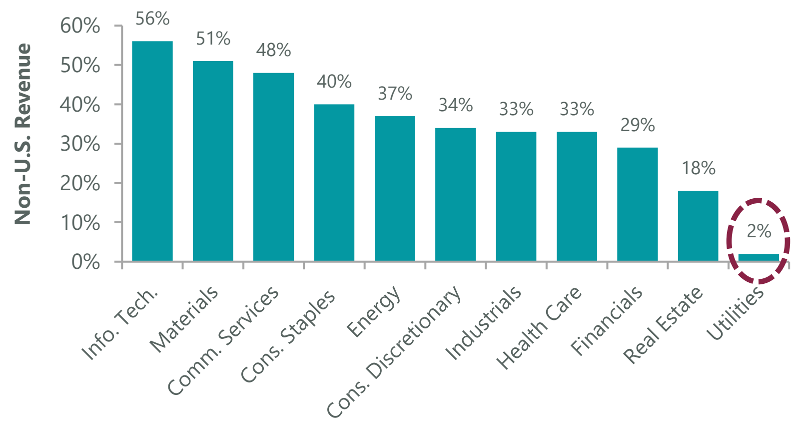
Market Overview

Infrastructure delivered positive returns in the first quarter, outpacing both global equities and U.S. equities, which were weaker amid higher policy uncertainty, specifically around tariffs. The AI trade, which worked well throughout 2024, continued to unwind following concerns around China's DeepSeek AI model representing a cheaper alternative to U.S. models.

Infrastructure's defensive nature was rewarded in this environment, with regulated utilities leading returns, in particular in Europe and North America. The Strategy in particular has benefited as tariff fears have taken hold as the largest weight in our infrastructure portfolios is to regulated utilities, which are notable for their lack of exposure to international trade, as utilities businesses are for the most part locally regulated entities delivering essential services (Exhibit 1). Regulated utilities actually may benefit in that their capital expenditures involve a high component of imported products, from steel to copper to transformers. Should these items increase in price due to tariffs, this will increase the utilities' asset base and therefore their earnings, assuming steady allowed returns from regulators.

Tariff fears have also been exacerbated by signs of slowing growth, raising recession concerns. Accordingly, bond yields have notably come down in 2025. This has been a boon to rate-sensitive communication towers, as well as renewables, which, while negative overall for the quarter, saw some improvement.

Exhibit 1: S&P 500 Sectors and Non-U.S. Revenue



As of February 28, 2025. Source: FactSet.

On the other side of tariff and recession fears, North American rails were weaker, as they are more GDP sensitive, while European airports and toll roads outperformed on optimism around the German fiscal stimulus package spurring growth.

Utilities are notable for their lack of exposure to international trade.

On a regional basis, the U.S. and Canada was the top contributor for the quarter, with U.S. electric utility Entergy the lead performer. Entergy is a pure regulated electric utility, providing services to approximately three million people in Arkansas, Louisiana, Texas and Mississippi. Entergy's share price rose on the back of another guidance upgrade.

Turning to Western Europe, German electric utility E.ON also outperformed for the quarter. E.ON runs one of the world's largest investor-owned electric utility service providers and is the largest distribution system operator in Germany. Across Europe, it has 47 million customers. The Germany Infrastructure Fund bodes well for the investment environment across the nation's electricity network, of which E.ON is a beneficiary.

French airport operator Aeroports de Paris and U.S. electric utility PG&E Corporation were the largest detractors.

Aeroports de Paris (ADP) owns and operates three airports in Paris, including Charles de Gaulle (CDG), Orly and Le Bourget, as well as minority stakes in several global airport groups, including TAV in Turkey and Schiphol in Holland. In our view, investors are overreacting to management's investment plans over the next 5-10 years at its Paris airport assets (CDG and Orly). Our conversations with management and stakeholders give us comfort that the market is overestimating the size of the capex and underestimating the allowed returns necessary to trigger investments. We expect this to be cleared up in the coming quarters.

PG&E is a regulated utility operating in Central and Northern California serving 5.3 million electricity customers and 4.4 million gas customers in 47 of the 58 counties within the state. PG&E shares underperformed following the Southern California wildfires, which heightened investor concerns over wildfire-related liabilities and the company's overall risk exposure.

Outlook

Our outlook is for slowing global growth in 2025 with some regional nuances. Trump's policy agenda has so far been more disruptive than expected, and we anticipate uncertainty will weigh on U.S. growth. However, other regions such as Europe may see improving growth through a potentially constructive fiscal agenda across the region. We remain somewhat defensively positioned toward utilities, which we see as undervalued at present, as peak bond yields have resulted in multiples coming down in that space. Utilities themselves have very fundamentally strong growth profiles, particularly in the U.S., driven by AI data center power demand, industry decarbonization and resiliency spending. European utilities are getting more capex approved by regulators and are seeing returns tick up as well, providing robust long-term visibility in earnings growth. Hence, we would expect earnings across infrastructure and utilities to remain robust despite the higher levels of uncertainty throughout 2025, with infrastructure's defensiveness offering further upside.

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 four of seven sectors in which it was invested in the quarter, with electric and energy infrastructure sectors the top contributors and airports the main detractor.

Relative to the S&P Global Infrastructure Index and on a U.S. dollar basis, the Strategy outperformed in the first quarter, driven primarily by stock selection in the electric and toll roads sectors as well as an overweight to water utilities. Stock selection in the water utilities detracted, meanwhile, as did stock selection in the rails sector.

On an individual stock basis, the top contributors to absolute returns in the quarter were Entergy, E.On, Emera, WEC Energy Group and Redeia. The main detractors were PG&E, Aeroports De Paris, CSX, United Utilities and Canadian National Railway.

During the quarter, we initiated positions in French toll road operator Vinci, U.K. electric utility SSE and U.S. electric utility Public Services Enterprise Group. We exited our positions in U.S. electric utilities Dominion and PG&E Corporation.

All returns are in local currency unless otherwise indicated.

Performance source: Internal. Benchmark source: Standard & Poor's.