All roads lead to infrastructure: An outlook for investors

From CBRE Investment Management

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When we consider the outlook for infrastructure, we see a toast to the future, a toast to the past and a toast to investors far and near. In this new year, we find that global listed infrastructure offers multiple benefits for investors:

Differentiated and consistent earnings potential that can outperform amidst persistent inflation.

Resilient performance during periods of contracting and moderating growth, during which the asset class has historically seen relative multiple expansion.

Accelerating investment growth driven by secular themes of energy security, decarbonization, and digitalization.

Upside potential into the final stages of the Federal Reserve rate hike cycle.

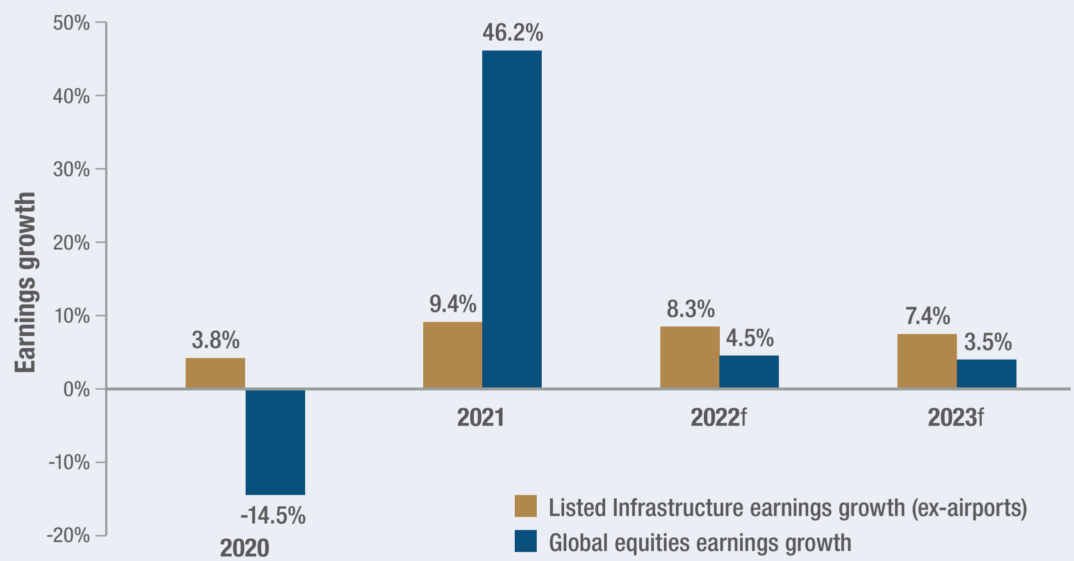
New York Life Investments

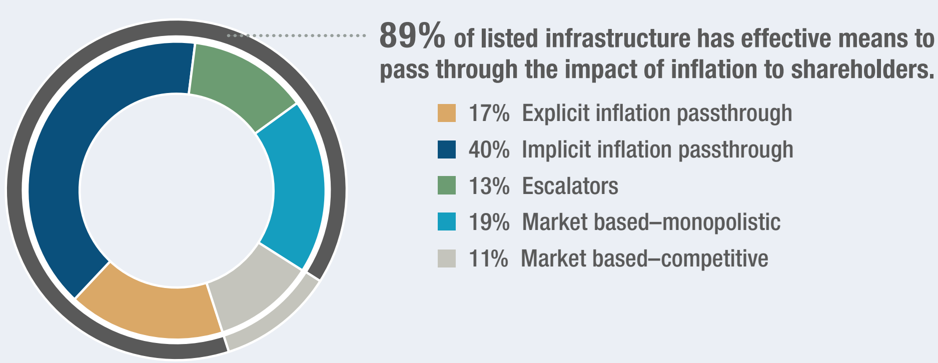
The 2023 opportunity in infrastructure

Resilient against slowing growth and inflationary pressures

As we look into 2023, the primary concern for equity investors remains slowing growth as central bankers tighten monetary policy to combat stubborn inflation. Considering this, infrastructure stands well-positioned. In 2023, we expect resilient infrastructure earnings to outpace global equities, while still-sticky inflation (even after a likely 2022 peak) should lend support to an asset class in which ~90% of constituents pass inflation on to end-users.

Figure 1: Infrastructure offers differentiated growth and inflation hedged cash flows



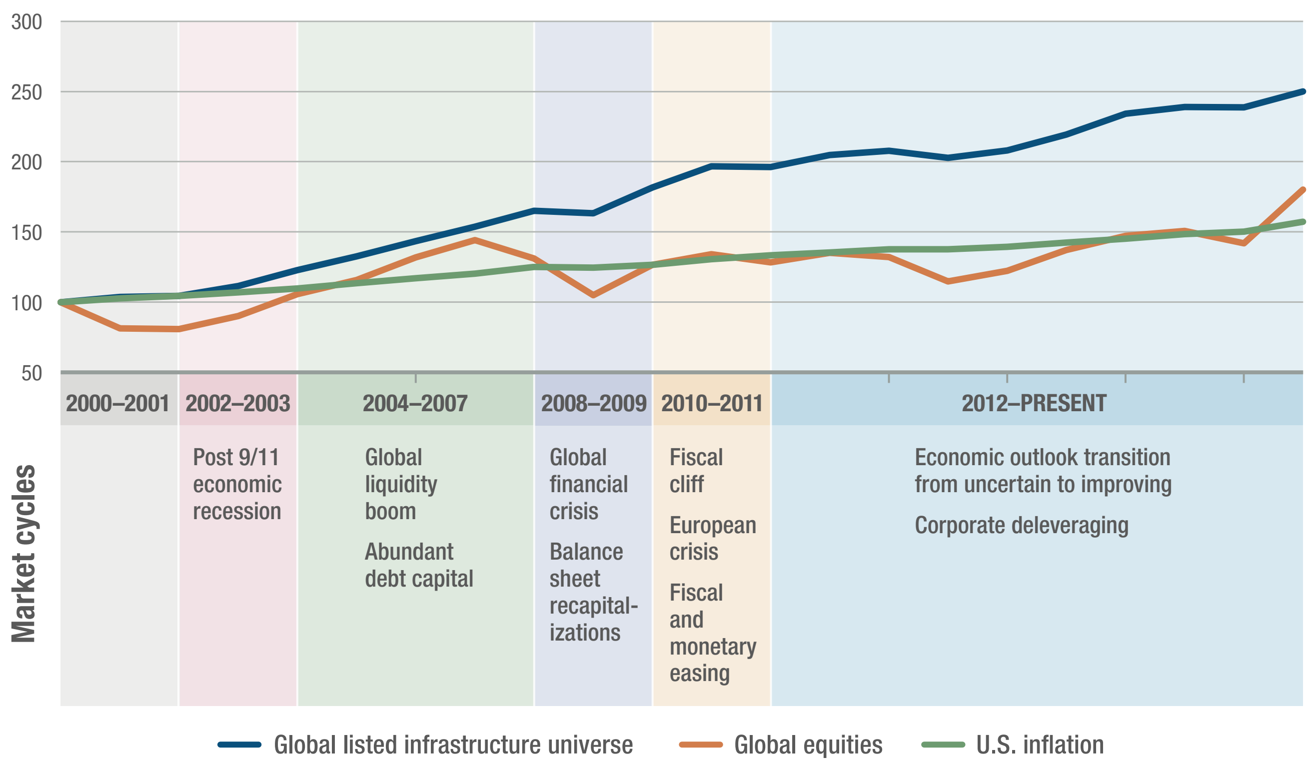


Sources: CBRE Investment Management, FTSE Global Core Infrastructure 50/50 Index, and iShares MSCI ACWI ETF (FactSet); as of 11/30/2022. "f" refers to "forecasts." EPS growth excludes airports due to the underlying volatility of traffic estimates post 2019. EPS estimates can be affected by assumptions concerning revenue growth, operating margins, interest rates, and tax rate assumptions. Actual results, performance, or events may differ materially from those expressed or implied in such statements. There is no guarantee that the investment objective will be attained and there is no guarantee that risk can be managed successfully; results will vary. Past performance is no guarantee of future results.

With each earnings season, the pincers of higher inflation and slowing demand are squeezing general equities. Infrastructure earnings are highly certain, inflation-protected and have growth potential.

The prospects for global equity earnings are highly uncertain. Currently, consensus expects only 3.6% growth in 2023, a moderation from February expectations of 8.6%.[1] With each passing earnings season, the pincers of higher inflation (on costs) and slowing consumer demand (on revenues) squeeze the margins of general equities. By contrast, infrastructure earnings are built upon a bedrock of contracted, regulated, and potentially inflation-protected returns. For example, a utility or transport company can earn from an asset for decades, while customer tariffs can rise with inflation. On top of this bedrock, infrastructure earnings should be growing due to a combination of countercyclical and secular investments. Global utilities are racing to install hundreds of gigawatts of wind and solar power while regulated grids upgrade their systems to prepare for that capacity. Cell towers and data centers continue to ratably grow in the service of data demand that will likely quintuple over the next several years, while transports and midstream infrastructure reprice tariffs with inflation and drive our energy security. Infrastructure's 2023 combination of resiliency and differentiated growth is why we expect cash flows to continue their long-term track record and outperform in this new year.

Figure 2: Infrastructure has offered reliable cash flow growth across market cycles

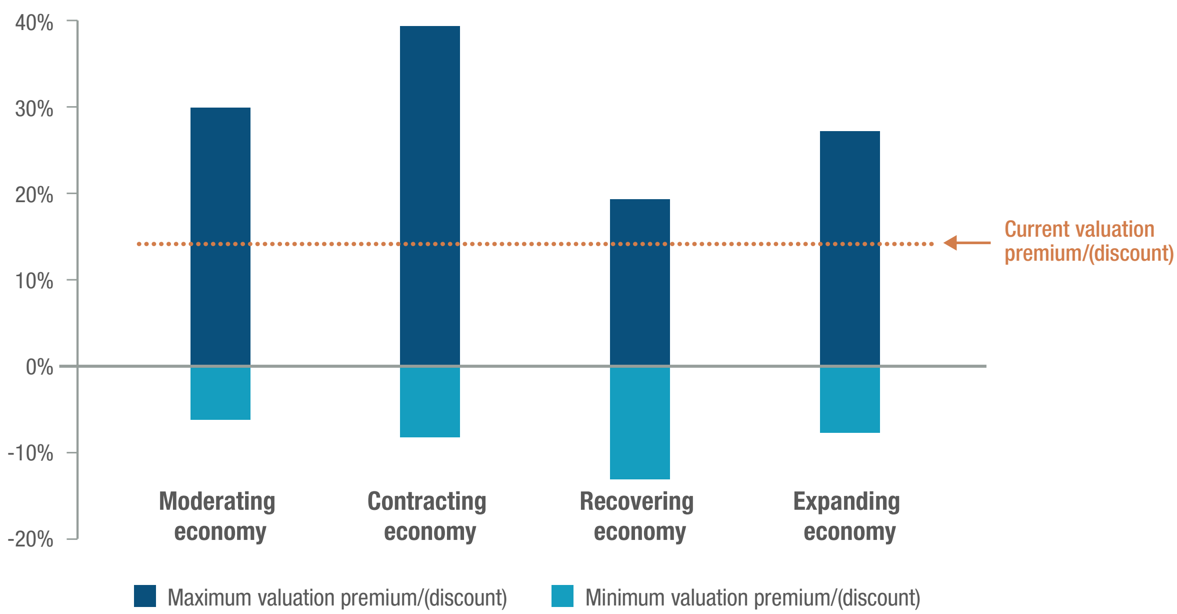


Sources: Global infrastructure universe is represented by CBRE Investment Management's infrastructure investable universe, Global Equities: MSCI ACWI Index and U.S. Inflation: U.S. Consumer Price Index data as of 12/31/2021. 2021 data is preliminary. This information is subject to change and should not be construed as investment advice. An index is unmanaged and not available for direct investment. For comparison purposes, company operating earnings and the U.S. Consumer Price Index values were rebased to 100 on 12/31/2000. Yields fluctuate and are not guaranteed. Past performance is no guarantee of future results.

The potential for relative multiple expansion

While infrastructure has outperformed broad equities in 2022, it has lagged over the last five years. Infrastructure also remains at a compelling valuation level considering the outlook of the world economy. Compared to broad equities, infrastructure assets typically fetch a premium, one which expands during periods of moderating or contracting economic growth. We would emphasize, as seen below, that in an environment of contracting economic growth, infrastructure has demonstrated the potential for its relative valuation multiple to more than double from current levels.

Figure 3: In a contracting economy, infrastructure's premium has historically more than doubled from current levels



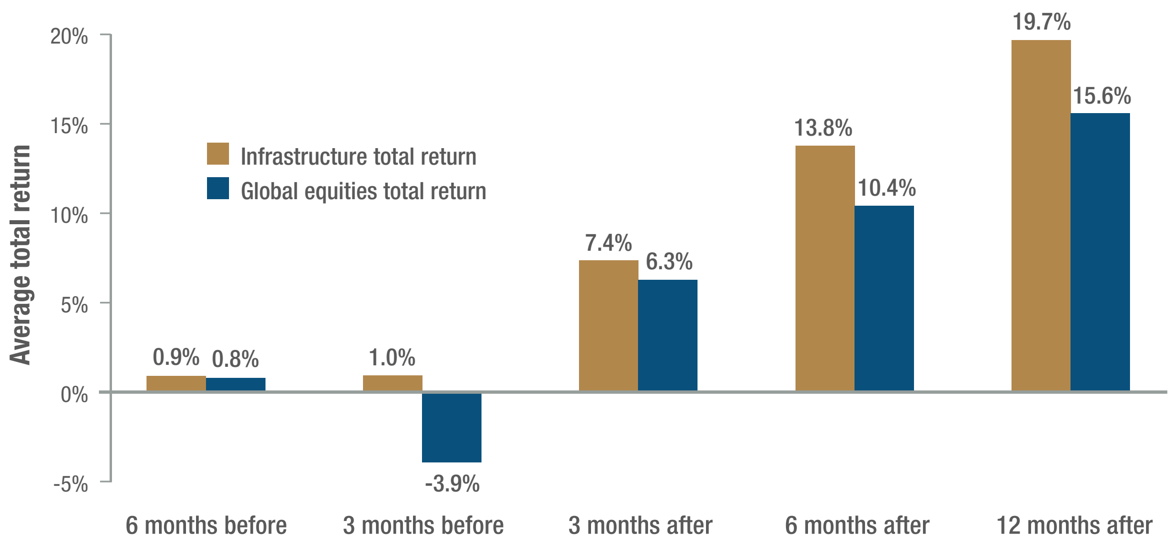
Sources: CBRE Investment Management, iShares MSCI ACWI ETF, SPDR S&P Global Infrastructure ETF, ProShares Dow Jones Brookfield Global Infrastructure ETF, as of 11/30/2022. Considers relative valuations between infrastructure and the MSCI World Index during moderating, contracting, recovering, and expanding phases of the economic cycle as calculated by the U.S. Economic Cycle Indicator, which is calculated using the year-on-year change in the Conference Board's Leading Economic Index (LEI), normalizing its history using a z-score, and tracking the 3-month moving average of that z-score. The Economic Cycle is determined by both the level and the change in the indicator, requiring two months in the same cycle in order to confirm a new cycle. Past performance is no guarantee of future results. An index is unmanaged, not subject to fees and transaction costs like an actual account. An investor cannot invest directly in an Index.

An opportune moment considering interest rates

Often, investors worry about the effect of higher rates on a yield-oriented asset such as infrastructure. This year's performance belies such fears as infrastructure's 2022 outperformance has come amidst one of the fastest-paced hiking cycles in the last forty years. Data over the long-term should further dispel rate-driven concerns as historically infrastructure has presented just a ~0.3 correlation to bonds and outperformed them by ~700bps annually.[2]

When we consider the likely path and pace of future central bank hikes, particularly those by the U.S. Federal Reserve, we see further reason for investors to consider allocating to infrastructure. Simply put, investors don't need to wait for the end of a hiking cycle to consider the asset class. As we show below, infrastructure outperformance compared to global equities has historically accelerated 3-6 months before the final hike in a hiking cycle. As a result, if investors believe that the Fed is likely to slow and pause in spring 2023 or earlier, amidst a potentially deteriorating economy, history suggests that the moment to buy infrastructure may be today.

Figure 4: Historically, infrastructure outperformance has accelerated 3-6 months before a final Fed hike



Sources: CBRE Investment Management, using data obtained from Datastream, a service provided by Refinitiv, a market data provider. Refinitiv Datastream, considers the performance of listed infrastructure stocks before and after the closest monthly end dates to the final Fed hikes in 1995, 2000, 2006, and 2018. For the 2000, 2006, and 2018 cycles, listed infrastructure is represented by the UBS Global Infrastructure & Utilities 50/50 Index linked as of March 1, 2015 to the FTSE Global Core Infrastructure 50/50 Index. For the 1995 cycle analysis, infrastructure prior to 12/31/1994 is represented by a 50/30/20 blend of the Refinitiv Datastream utility, pipeline, and rail indices. Global equities are represented by the MSCI World Index. Past performance is no guarantee of future results. An index is unmanaged, not subject to fees and transaction costs like an actual account. An investor cannot invest directly in an Index.

A comprehensive view of the infrastructure investment opportunity

When summarizing the 2023 outlook, we see the present moment as presenting several of the factors conducive to potential infrastructure outperformance.

Infrastructure's relative earnings momentum to broad equities has been improving; the asset class is accelerating secular investment while global equities face significant margin pressure.

Inflation remains persistent, a potential boon to the revenues of an asset class with a history of inflation resiliency and price inelastic demand.

Relative valuation is compelling: while above historical averages, relative premiums have more than doubled from current levels during prior periods of contracting economic growth.

Against this backdrop, the prospects for fundamental investment continue to rise, driven by secular investments in projects related to decarbonization, digitization, and energy security.

As an added bonus, the prospects for active management of the infrastructure asset class are bright. Infrastructure is a niche asset class that is both underfollowed and under-owned by generalists, while listed assets are informed by a vast private market that managers with integrated public-private research platforms can research to drive alpha. As we eclipse this past year and look to those ahead, we are excited to report future results.

[1] Source: CBRE Investment Management, FactSet, as of 11/30/22

[2] Source: CBRE Investment Management. Infrastructure and bond correlation and performance are based on the UBS Global Infrastructure & Utilities 50/50 Index linked to FTSE Global Infrastructure 50/50 Index and the Bloomberg Global Aggregate Index since 1997 and 2002, respectively.

[3] The peer group is Morningstar Infrastructure Category—Infrastructure equity funds which invest more than 60% of their assets in stocks of companies engaged in infrastructure activities. Industries considered to be part of the infrastructure sector include: oil & gas midstream; waste management; airports; integrated shipping; railroads; shipping & ports; trucking; engineering & construction; infrastructure operations; and the utilities sector.

INDEX DEFINITIONS

The **Conference Board Leading Economic Index** is an American economic leading indicator intended to forecast future economic activity.

FTSE Global Core Infrastructure 50/50 Index is a market-capitalization-weighted index of worldwide infrastructure and infrastructure-related securities.

iShares MSCI ACWI ETF seeks to track investment results of an index composed of large and mid-capitalization developed and emerging market companies.

MSCI ACWI Index is designed to represent performance of the full opportunity set of large- and mid-cap stocks across 23 developed and 24 emerging markets.

MSCI World Index is a broad global equity index that represents large and mid-cap equity performance across 23 developed markets countries. It covers approximately 85% of the free float-adjusted market capitalization in each country. MSCI World Index does not offer exposure to emerging markets.

ProShares Dow Jones Brookfield Global Infrastructure ETF seeks investment results, before fees and expenses, that track the performance of the Dow Jones Brookfield Global Infrastructure Composite Index.

SPDR S&P® Global Infrastructure ETF seeks to provide investment results that, before fees and expenses, correspond generally to the total return performance of the S&P® Global Infrastructure Index.

UBS Global Infrastructure & Utilities 50/50 Index tracks a 50% exposure to the global developed-market utilities sector and a 50% exposure to the global developed-market infrastructure sector.

U.S. Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services in the U.S.

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