



Global Infrastructure Value Strategy



Charles Hamieh
Managing Director,
Portfolio Manager



Shane Hurst
Managing Director,
Portfolio Manager



Nick Langley
Managing Director,
Portfolio Manager

Key Takeaways

- ▶ Our Strategy performed well versus the infrastructure benchmark, which underperformed global equities for the quarter.
- ▶ On a regional basis, the U.S. and Canada region was the top contributor to quarterly performance, where energy infrastructure companies stood out.
- ▶ We expect an asynchronous global recovery, with the effect that the recovery peaks will be more spread out and therefore prolonged.

Market Overview

Our Strategy performed well versus the infrastructure benchmark, which underperformed global equities for the quarter.

Economic activity continues to rebound strongly with expected upgrades to consensus earnings and economic growth forecasts.

COVID-19 vaccine rollouts gained pace in many regions, although mobility restrictions remained significant as a result of the new Delta variant. With the combined effect of new restrictions and the continuation of vaccinations, the rate of confirmed cases globally has started to decrease.

Government policy remained supportive, with continued implementation of previously announced stimulus. Bond rates declined slightly in June, post the June FOMC meeting as the Fed continues with view that the recent inflation spike is largely transitory, with upside risk able to be addressed through potential tapering discussions later in the year. Strong labor and wage data, combined with large increases in commodity prices, highlight the risk of inflation to the upside; however, significant slack in the labor markets is expected to contain inflation risk. Markets performed solidly on the back of strong economic data and confidence the Fed will act accordingly to contain inflation.

On a regional basis, the U.S. and Canada was the top contributor to quarterly performance, of which U.S. energy infrastructure company Cheniere Energy, U.S. communications company American Tower and Canadian energy infrastructure company Enbridge were the lead performers.

Airports and toll roads are still trading at meaningful discounts to pre-pandemic levels.

Cheniere Energy owns and operates U.S. liquefied natural gas (LNG) export facilities. Cheniere performed in line with the U.S. pipeline sector, as the current energy market remains constructive.

American Tower is a leading independent owner, operator and developer of wireless and broadcast communications infrastructure. The company has 41,000 sites in the U.S. and a further 139,000 sites across 19 countries, predominantly emerging markets (India 75k, Latin America 40k and Africa 18k). American Tower performed well after the U.S. network operators announced plans to deploy 5G spectrum, with investment much larger and much sooner than the market was anticipating.

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. Enbridge's Line 3 Replacement Project received a favorable court ruling regarding the adequacy of its Environmental Impact Statement. This significantly lowers the execution risk for the project and enables the company to place the project into service later in the year.

Turning to Western Europe, Spanish communications company Cellnex Telecom also performed strongly. Cellnex is Europe's leading independent infrastructure owner and operator for wireless telecommunication. Cellnex shares increased during the quarter as the overhang from capital requirements dissipated, bond rates stabilized and the focus on M&A opportunities returned with Deutsche Telekom highlighting its willingness to sell its portfolio.

U.S. renewables utility Brookfield Renewable Corporation was the largest detractor from quarterly performance. Brookfield Renewable is a pure-play renewables operator and developer headquartered in Canada, 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 Brookfield an attractive partner. Brookfield's development pipeline stands at 18,000 MWs, providing confidence the company can meet its targeted double-digit cash flow growth through to 2025. Shares wavered along with broader weakness across the renewables sector.

Positioning and Outlook

On a regional level, the Strategy's largest exposure is in the U.S. & Canada (55%) and consists of exposure to regulated and contracted utilities (32%) and economically sensitive user pays infrastructure (23%).

During the quarter we initiated positions in Canadian rail operator Canadian National Railway and U.S. electric utility CenterPoint

Energy; we exited U.S. electric utilities Pinnacle West and Sempra Energy, U.S. renewable utility NextEra Energy Partners and Italian toll road operator Atlantia.

We are positive on the outlook for infrastructure. Pipelines continue to perform well amid the recovery trade, as do toll roads in Europe as mobility restrictions are being rolled back. Airports in Europe and Australia continue to underperform, as the Delta variant and a slow vaccine rollout continues to impact traffic. Renewables enjoyed a pull-forward in value in 2020 and have seen a pause in 2021, although they will continue to benefit from decarbonization as a large structural thematic. While normally a downward move for bond yields means a rally for utilities, the simultaneous weakness of utilities and bond yields recently is likely the result of the current quantitative easing program, seasonal factors, concerns around new COVID-19 variants and stabilizing economic activity.

The U.S. infrastructure bill is still being negotiated and will likely come in two packages; the first more certain and including spending on transmission upgrades benefiting the electrical grid and helping regulated utilities and renewables; the second, more focused on green infrastructure with proposed clean energy and nuclear tax credits, is less certain.

Regionally, the U.S. is ahead in terms of vaccinations, although Europe is catching up, with 52% of the U.K. population being fully immunized. We expect an asynchronous global recovery, with the effect that the recovery peaks will be more spread out and therefore prolonged. We are positioned for a growing recovery in Europe and are seeing airports and toll roads still trading at meaningful discounts to pre-pandemic levels. Our transport infrastructure exposure is primarily in the U.S., Europe and Australia, which we expect to be the strongest performers.

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 seven of the nine sectors in which it was invested (out of 11 total) in the second quarter, with the communications and toll roads sectors the leading contributors and the renewables and airports sectors the sole detractors.

On a relative basis, measured against the S&P Global Infrastructure Index, the ClearBridge Global Infrastructure Value Strategy outperformed during the second quarter. Overall stock selection and sector allocation contributed to performance, in particular stock

selection in the toll roads and electric sectors and the Strategy's overweight to the communications sector. Stock selection in the rail sector and underweights to the gas and energy infrastructure sectors, meanwhile, detracted from relative results.

On a regional basis, the U.S. and Canada region was the strongest contributor, while Asia Pacific Developed lagged.

On an individual stock basis, the largest contributors to absolute returns in the quarter were Cheniere Energy, Cellnex Telecom, American Tower, Enbridge and Spanish toll road operator Ferrovial. The largest detractors were Brookfield Renewable, Clearway Energy, Sydney Airport, Spanish electric utility Iberdrola and Canadian National Railway.

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