Global Listed Infrastructure
Protecting a portfolio from inflation

Asset Class Update

Aug 2014

The outlook for inflation is one of the most important factors for financial markets, currencies and economic growth. In recent years, the central banks of the world's major economies have pursued expansionary monetary policies in an attempt to stimulate growth rates and prices.

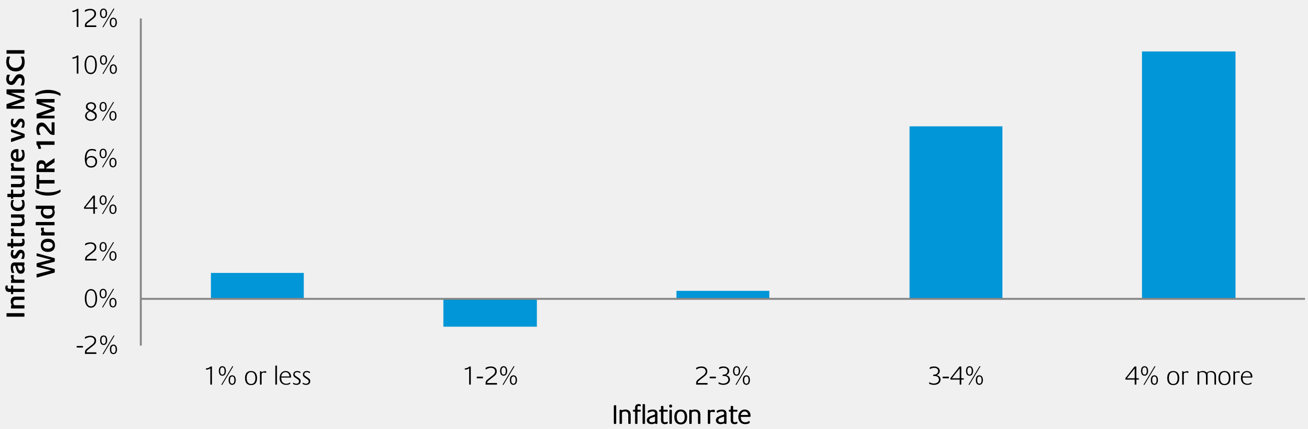
Recent upticks in UK and US inflation have seen investors start to re-focus on inflation's potential to erode the real value of investments, and the importance of protection from its effects. Investing in global listed infrastructure is increasingly being seen as a way of achieving this. Infrastructure assets tend to have the ability to consistently increase the price of their services over time.

This can be done explicitly, where regulation, concession agreements or contracts link pricing directly to the rate of inflation. The regulated pricing structures of water, electricity and gas utilities often refer to inflation. UK water utilities earn a real return on regulated assets, with prices increasing by RPI (the Retail Price Index). Electricity transmission companies including National Grid in the UK; Red Electrica in Spain; Terna in Italy; SP Ausnet in Australia; and ITC in the US vary in the way regulated returns are calculated. However all can claim to recover inflation over time. Toll road pricing often includes automatic, annual toll increases which are tied to inflation.

Other listed infrastructure sectors are generally not subject to such close regulation, but often have the pricing power to deliver a similar (or better) outcome due to strong strategic positions. Rail companies' pricing power has improved in recent years. In the US, rates for hauling freight are largely unregulated, and in theory, competition should prevent unreasonable rates. In practice however, the Class I railroads operate regional duopolies, giving them substantial pricing power, and the costs of seeking rate relief are often too high for shippers.

The chart below shows how valuable this inflation protection can be to investors. It compares the relative performance of listed infrastructure to equities when inflation is within a given band. For example, when inflation is between 3% and 4% pa, global listed infrastructure has outperformed global equities by over 6% pa on average. Importantly, this outperformance increases to above 10% when inflation is above 4% pa.

Infrastructure outperformance during high inflation



UBS Developed Infrastructure & Utilities Index (TR).
MSCI Daily TR Net World USD.
US CPI Urban Consumers YoY NSA

Monthly data for 20 years to Jun 2014
Source: Bloomberg, First State Investments

The degree of protection will vary by asset, and passively investing in the asset class does not guarantee a hedge to inflation. Significant qualitative assessment is also required. Key issues to consider – as always with this asset class - are the transparency of regulation and the risk of political interference.

However, our studies have found that more than 70% of assets owned by listed infrastructure companies have effective means to pass-through the impacts of inflation to customers, to the benefit of shareholders. This characteristic suggests that an allocation to listed infrastructure may suit long-term investors who are concerned about the impact of inflation, and who want to ensure that their investments maintain and grow their value in real terms over time.