

Listed infrastructure: Factors aligning for renewed investor attention

We believe an attractive entry point for listed infrastructure is emerging, considering the potentially favorable macro environment and the asset class's attractive valuations relative to broader equities.

The road ahead: Potential return of outperformance

Given current valuations in listed infrastructure, and with an eye on the macro horizon, we believe more hospitable conditions for the asset class may lie ahead. Attractive relative valuations stem from infrastructure stocks' underperformance in 2023 despite a resilient earnings outlook, rising just 2.2% for the year, compared with a gain of 23.8% for global stocks.

Our macro outlook is supportive of infrastructure. As we progress through 2024, we believe global growth is poised to slow further. Interest rates are likely to remain elevated, despite a more dovish sentiment shift, and inflation, while falling, is likely to remain above trend with ample inflationary catalysts abounding. This macroeconomic backdrop has typically been a strong setup for infrastructure stocks, as defensive businesses that exhibit inflation protection, pricing power, and/or pass-through capability tend to be relative beneficiaries in late cycle and recessionary periods.

KEY TAKEAWAYS

Global economic growth is likely to slow in 2024, underscoring the appeal of infrastructure's relatively stable cash flows.

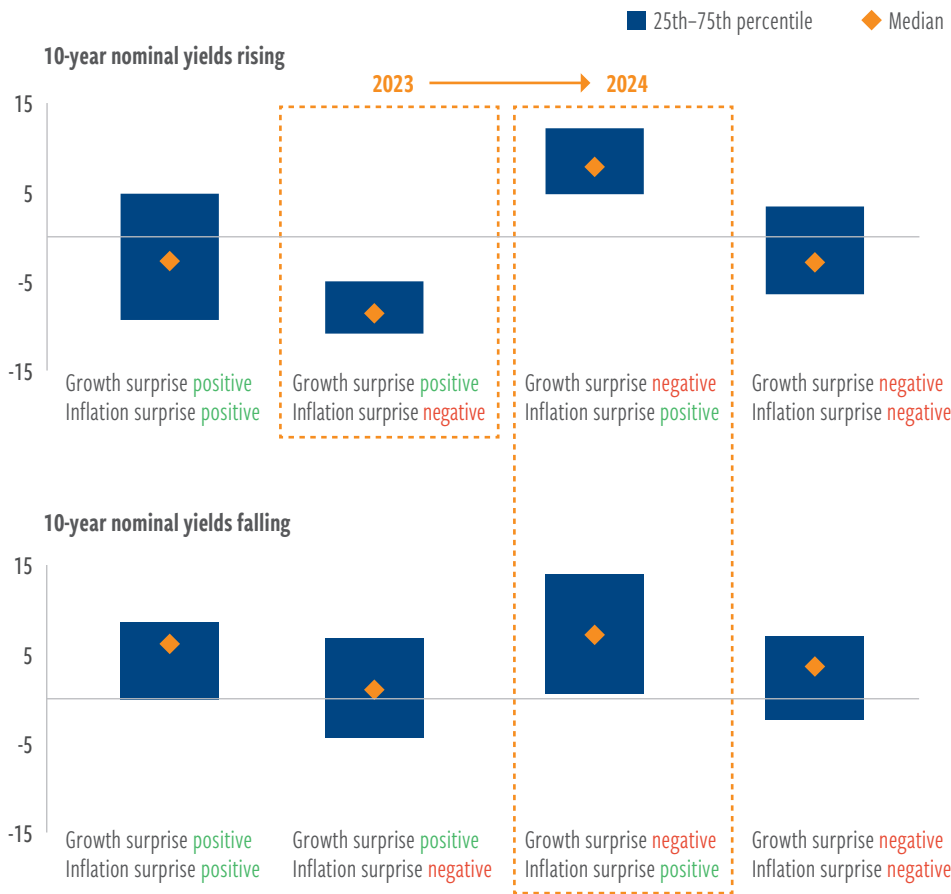
Listed infrastructure is trading at uniquely attractive valuations compared with global stocks.

Our favored subsectors at present include cell towers and midstream energy based on valuations and cash-flow trends.

More hospitable macro conditions and compelling valuations could drive favorable sentiment toward infrastructure in 2024.

As suggested in Exhibit 1, 2024 may potentially unfold as a better macro regime for infrastructure.

EXHIBIT 1
Relative performance of infrastructure in various macro regimes
Real total return relative to MSCI World equities (1979–2023)



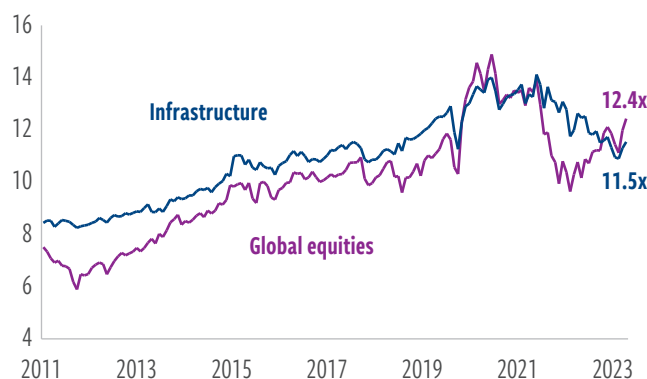
At September 30, 2023, Cohen and Steers proprietary analysis. Surprise compared to expectations 12 months prior, based on the Philadelphia Fed Survey of Professional Forecasters (SPF) median real GDP forecast and University of Michigan Consumer Survey.

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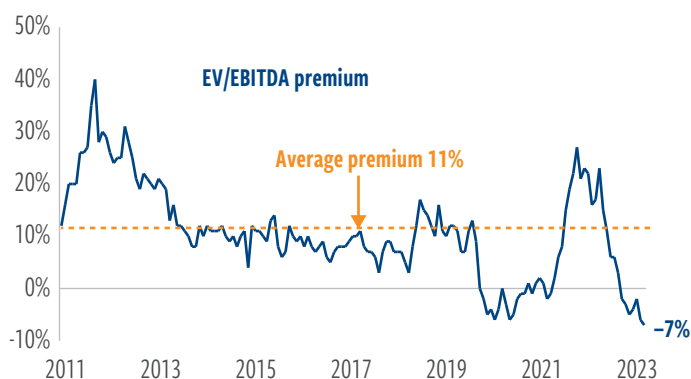
With respect to valuations, global listed infrastructure screens uniquely cheap today compared to global equities, in part a consequence of its relative underperformance in 2023. On an enterprise value-to-cash flow multiple basis, for instance (right hand side in Exhibit 2) listed infrastructure is trading at a discount to global equities—in sharp contrast to the asset class’s historical premium valuation. We believe a premium valuation is warranted given the relative EBITDA (cash flow) predictability of infrastructure, and relatedly, the consistent demand for infrastructure services throughout the economic cycle. Any reversion towards the average premium would imply a period of outperformance for infrastructure stocks.

EXHIBIT 2

Infrastructure vs. global equities EV/EBITDA⁽¹⁾ December 2010–December 2023



Infrastructure is trading at a discount to global equities⁽²⁾ December 2010–December 2023



At December 31, 2023. Source: MSCI, FTSE, FactSet and Cohen & Steers

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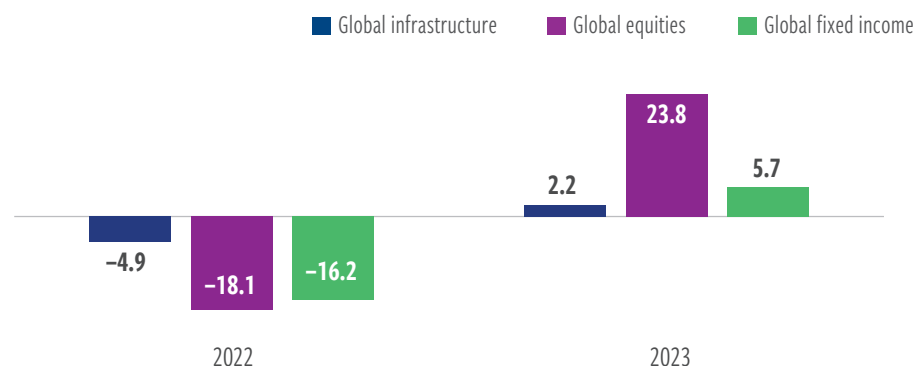
The impact of higher rates feels heavily reflected in infrastructure valuations today. In the meantime, equity market implied earnings growth and multiples don't appear sustainable in the weakening economic backdrop. It's our belief that equity markets may re-rate lower in the months ahead while the defensiveness and inflation beta of global listed infrastructure is likely to support the asset class, even if rates remain elevated.

With regard to where we've been, taking a two-year view provides some useful context. The asset class entered 2023 having substantially outperformed equities in 2022, which was a very difficult period for financial markets amid slowing growth expectations, rapidly rising inflation and a steady increase in interest rates.

EXHIBIT 3

Listed infrastructure performance in a two-year context

Performance recap as of 12/31/23



At December 31, 2023. Source: Cohen & Steers, MSCI, FTSE.

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That confluence of macro headwinds underscored the importance of relatively predictable cash flows as well as positive inflation sensitivity—attributes associated with infrastructure companies, which provide essential services and which tend to have inflation-linked pricing mechanisms. As a result, global listed infrastructure materially outperformed both equities and fixed income, as shown in the table above.

The midstream energy subsector was among the best performers in 2022, as these businesses tend to have strong inflation linkages and indirect commodity price exposure. Transportation companies, such as airport and toll road operators, also performed well, amid the final stages of pandemic-related travel reopening.

Infrastructure's outperformance in 2022 reflected its tendency to hold up well in down markets.

A new year, some new macro shifts

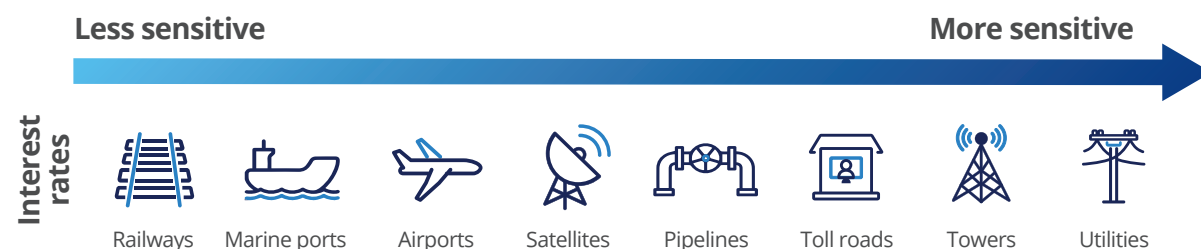
When looking to explain listed infrastructure's underperformance in 2023, a basic starting point is a shift in the macro picture. While global economic growth continued to slow, it was generally stronger than expected over the course of 2023. This, combined with falling inflation, lessened the appeal of infrastructure's defensive qualities.

The 2023 reversal in listed infrastructure's relative performance is also in part attributable to three other notable factors.

- **No exposure to technology:** A key distinguishing tailwind for equity markets in 2023 was the dominance of a handful of leading technology companies, in particular those tied to the expansion of artificial intelligence (AI). The technology sector, which accounts for about 20% of the MSCI World Index, climbed 54% in 2023. The global listed infrastructure universe does not include technology companies, and hence did not participate in that rally.
- **Yield alternatives:** Some infrastructure investors are attracted to the asset class given its relatively high dividend yield. In 2023, for the first time in years, interest rates rose to levels that made fixed income investments a viable alternative to higher yielding equity asset classes. With that said, we continue to emphasize that listed infrastructure is a “yield plus growth” proposition, whereas fixed income securities (bonds) do not have the potential to grow their payouts.
- **Materially higher cost of capital:** Infrastructure is a capital-intensive asset class, with substantial investments required to maintain and grow companies' asset bases. Many subsectors, utilities in particular, rely on external capital to fund their growth—meaning issuances of debt and equity. Exhibit 4 below indicates the varying degrees of rate sensitivity across subsectors.

EXHIBIT 4

Interest-rate sensitivity can vary between subsectors



At December 31, 2023. Source: Cohen & Steers.

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One key feature of infrastructure businesses is that most have pricing mechanisms allowing the pass through of higher financing costs to the end customer. However, this can come with a lag by virtue of regulatory processes. Despite these pass-through mechanisms, rate sensitive sectors that rely on external financing were indiscriminately punished in 2023—in particular the utilities space. The selloff late in the third quarter was overdone, in our opinion, creating distinctive investment opportunities for active managers.

Cell towers have also underperformed, hindered in part by rising costs of capital. Valuations are now attractive, in our view, with price-to-cash-flow multiples at their lowest average level in six years, as shown in Exhibit 5. At the same time, we believe tower owners have likely moved past their trough in earnings growth.

EXHIBIT 5

Tower valuations at their most attractive level since 2017

Average valuation based on price/cash flow multiple (12 months forward)



At November 30, 2023. Source: Cohen & Steers.

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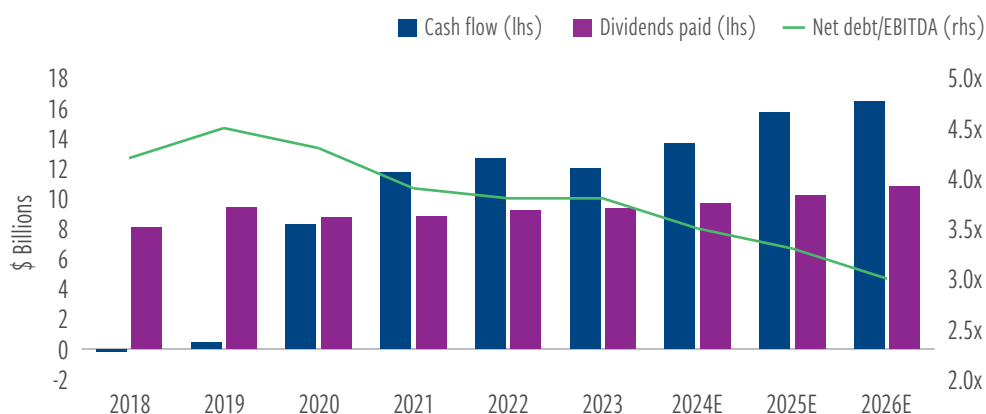
While these companies don't have the same degree of pricing protection found in many infrastructure subsectors, we maintain a favorable view of their longer-term fundamentals. Cell tower companies should continue to benefit from attractive organic growth (despite a recent slowing), driven by: annual lease escalators for U.S. companies (not directly tied to inflation), new co-location/densification revenues and lease amendments. Only about half of U.S. tower sites are 5G-enabled; we expect wireless carriers to continue investing for years to come until 5G penetration reaches close to 100%. In addition, data consumption continues to grow rapidly, approximately 20% a year, forcing carriers to densify their networks.

Another subsector we'd highlight in terms of favorable fundamentals is midstream energy. Midstream has transformed in the last several years, resulting in more compelling business models. In the early 2000s, midstream companies generated minimal cash flow, relying on debt and, in some instances, external equity financing, to grow. Extended balance sheets and aggressive dividend policies forced the subsector to change in an accelerating manner over the past five years. Companies adopted capital discipline, slowed their dividend growth, and focused on de-leveraging balance sheets.

These moves have been associated with a steady decline in midstream companies' leverage ratios (net debt relative to cash flows, as shown in Exhibit 6 below), with leverage settling in the 3–4x range, while free cash flow have continued to grow. That is an optimal capital allocation approach for these types of companies in our view, and should allow for continued increases in free cash flow generation, share repurchases, accelerated dividend growth, and/or acquisition opportunities in 2024 and beyond.

EXHIBIT 6

U.S. pipeline companies have improved their balance sheets



At November 30, 2023. Source: Cohen & Steers.

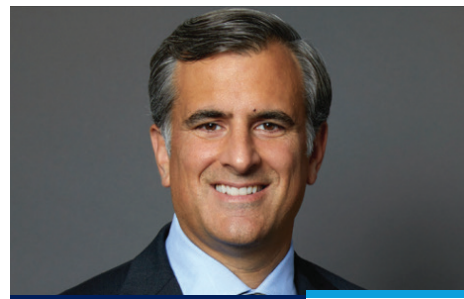
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The appeal of a long-term allocation

In closing, we believe the long-term case for global listed infrastructure remains compelling. The asset class has a history of equity-like returns with a meaningful downside cushion, as well as relatively low volatility of earnings stemming from typically long-term contracts and the essential service-providing nature of infrastructure businesses.

About the author

Benjamin Morton, Executive Vice President, is Head of Global Infrastructure and a senior portfolio manager for Cohen & Steers' infrastructure portfolios. He has 23 years of infrastructure-related investment experience. Prior to joining Cohen & Steers in 2003, Mr. Morton worked at Salomon Smith Barney as a research associate for three years, covering the utilities and pipelines sectors. He also worked at New York Mercantile Exchange as a research analyst. Mr. Morton holds a BA from the University of Rochester and an MES from Yale University. He is based in New York.



Index definitions / important disclosures

An investor cannot invest directly in an index and index performance does not reflect the deduction of any fees, expenses or taxes. Index comparisons have limitations as volatility and other characteristics may differ from a particular investment.

Global listed infrastructure: FTSE Developed Core Infrastructure 50/50 Index, a market-capitalization-weighted index of infrastructure and infrastructure-related securities in worldwide developed markets; constituent weights are adjusted semi-annually according to three broad industry sectors: 50% utilities, 30% transportation, and a 20% mix of other sectors, including pipelines, satellites, and telecommunication towers. **Global equities:** MSCI World Index, a free-float-adjusted index that measures the performance of large- and mid-capitalization companies representing developed market countries and is net of dividend withholding taxes. **Global bonds:** Bloomberg Global Aggregate Bond Index, which includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.

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