



# Partners Group

REALIZING POTENTIAL IN PRIVATE MARKETS

31 MARCH 2022

## Q1 2022 Review

Partners Group Listed Investments SICAV – Listed Infrastructure



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## 2022 Q1 review

### Key market drivers

Global equity markets have had a shaky start to 2022, following a number of unforeseen events. While the rise in inflation was expected late last year, the impact on the equity markets was felt in Q1 2022 and the US Fed increased rates by 25 bps for the first time since Q4 2018. During February 2022, Russia launched an invasion on Ukraine, which further led to a decline in equity markets. The US and Europe consequently announced sanctions on Russia, which however had a positive impact on the energy sector (including midstream pipelines), though broader equity markets clearly remained pressured. In the second half of March 2022, there were first signs of an emerging peace treaty between Russia and Ukraine, which led to a recovery in the equity markets, though the performance for the full quarter remained negative. Finally, the US Fed and the ECB may announce further rate increases for the rest of the year, as inflation remains high in both the regions.

During this volatile quarter, the Partners Group Listed Investments SICAV - Listed Infrastructure grew by 2.5%, while broader equity markets measured by the MSCI World TR index, decreased by 2.5%. However, the Fund underperformed its benchmark significantly, largely due to the underweight to energy pipelines and a large active position in communication infrastructure. The performance across sub-sectors was mixed, as energy pipelines and railroads performed strongly, while communication infrastructure in particular was a weak performer. Among regions, North American equities performed strongly, while Chinese equities in the portfolio delivered a negative return.

### Key portfolio drivers

The transportation infrastructure sector performance in Q1 was overall strong led by railroads, followed by airports, while toll roads were relatively flat. Railroads have continued to perform well from Q4 last year as they are seen as having strong pricing power, which should benefit them in a rising inflationary environment. There is also growing expectation that airport passenger growth may recover swiftly this year, which led to a good performance of the airport operators. Rumo, the Brazilian railroad operator, was one of the strong performers during the quarter as it reported good volumes in February (22% year-on-year growth), confirming the positive trend from January. YTD volumes are up 47% year-on-year and the market expects continued strong volumes, driven by high commodity prices of agricultural products. High fuel prices also put railways in a better competitive position compared to trucks, which are less fuel efficient, driving better top-line pricing. The Italian infrastructure investment holding company Atlantia was another strong performer as it reported solid FY 21 results and hosted its investor day in March. Now that all conditions for the sale of its stake in Autostrade per l'Italia S.p.A. have been met, the company can focus on redeploying the proceeds, commencing a EUR 2 billion buyback program and planning to deploy EUR 5 billion in core infrastructure assets. Moreover, there is increasing optimism on traffic recovery, especially for airports, and there has been limited evidence so far that higher fuel prices are reducing traffic.

Communication infrastructure recovered in March but was overall the worst performing segment during the quarter. The Spanish tower operator Cellnex was particularly weak as it emerged that two telecom carriers in Italy may be considering a merger, though it is unclear whether the regulator would approve such a transaction. Additionally, Deutsche Telecom communicated that it is considering many strategic options for its tower portfolio, and Cellnex is understood to be very interested in it. The tower operators Crown Castle and American Tower were also weak during the quarter, though Crown Castle reported very healthy FY 2021 numbers and leasing activity is set to improve in FY 2022. Equinix, the only data center

operator in our portfolio, also performed poorly, though the company reported strong FY 21 numbers and provided a robust guidance for FY 22. Despite the poor performance, driven to a large extent by macro factors such as inflation and rising interest rates, we believe the segment is in a strong position to grow earnings and margins despite higher cost pressures.

Within energy and utilities, the energy pipelines sub-sector continues to perform strongly, as they further benefited from sanctions on Russia, which led to a rise in oil and gas prices. The pipelines have delivered modest performance for a few years, and their growth outlook remains rather moderate, but cash flows and the balance sheets are in healthier condition than they were even two years ago. Furthermore, most of these companies are paying more than 5% sustainable dividend yield. Finally, the US gas pipeline operator Williams reported record volumes on one of its main pipeline assets in FY 21 – a trend we think will continue this FY. The regulated utilities, after a rather modest performance in the past two years, have recovered well this year and contributed positively to portfolio performance. The regulated utilities have remained largely unaffected by the pandemic and are also continuing to deliver on their investment plans, despite rising inflation and geopolitical events. Sempra Energy, the North American utility, has been one of the main beneficiaries of the shift in EU energy policy away from Russian gas, given it owns LNG terminals, used mainly for exports. During March, the US announced a deal with the EU to export additional 15bcm of LNG in 2022, and potentially increasing exports by 50bcm over this decade. During the month, Sempra Energy also announced the memoranda of understanding with TotalEnergies to build a new LNG terminal in Mexico, and that it plans a 60% capacity increase at its Cameron LNG terminal in Louisiana by 2027. On the flip side, the Chinese gas distributor ENN Energy was among the weakest performers during the quarter as investors are concerned that its gas volumes may not increase by 15% this year, owing to higher gas prices, and therefore dollar margins could be squeezed. The waste managers and the water utilities performed poorly as well, but there was little company specific news, and both sub-sectors were largely affected by broader market volatility.

Finally, social infrastructure was modestly positive during the quarter, underlining the inherent stability of their portfolios.

### **Portfolio positioning and outlook**

Though regulated utilities remain the largest allocation in the portfolio currently, over the past year, we have been increasing exposure to towers and railroads by reducing exposure selectively to pipelines and airports, as well as to cash. Other sectors where we have also increased exposure are waste managers and data centers. While we do not believe that the risks associated with Covid-19 have abated fully, we found that certain companies offered compelling valuations for us to consider increasing them. In the past quarter, we divested two positions – the Brazilian toll road operator CCR and the Australian gas pipeline operator APA Group – while adding a new railroad operator, CSX, and increasing our positions in two other railroad stocks, Aurizon and Rumo. Our reasoning is that the railroads remain in a strong position in a rising inflationary environment due to their pricing power, and the valuations were relatively more attractive.

Communications infrastructure will remain one of our key sector focuses in 2022, and perhaps over the next few years, given the strong tailwinds for the sector. We continue to see large investment needs for the sector that could drive earnings growth over the medium to long term. We see more scope of outsourcing towers by MNOs in Europe, and the 5G investments by the US-based MNOs are expected to accelerate further. Data centres are also expected to benefit



from such long-term secular trends. We have been increasing our position in communication infrastructure throughout 2021, which had supported the strong performance of the Fund last year. Despite the poor performance in Q1, we find that underlying fundamentals and leasing activity all remain robust.

Regulated utilities have performed relatively well in Q1, but we continue to see good opportunities within this sub-sector. Share performance for the sector overall has been relatively modest over the past 18-24 months, while underlying earnings growth was consistent, leading to lower valuations for the sector. None of these utilities have modified their medium-term investment plans or seen unfavorable changes to their regulation, both of which are promising indicators for the sector's earnings growth potential. However, within the sector, we continue to emphasize on electric and water utilities, and have changed allocations accordingly. Furthermore, those utilities that are subject to stable regulation, have a strong balance sheet and meaningful capex on their regulated asset base, should also provide better performance even in a rising interest rate environment.

We remain positive on the US waste managers, and our exposure to the sector has grown accordingly over the past 24 months. Finally, while performance of transport infrastructure has recovered to some extent, we find that toll road traffic recovered meaningfully during this summer, but airport passenger numbers remain rather weak. We continue to take a cautious approach on the sector and believe traffic on toll-roads will recover faster than airports, as appetite for travel remains and people may perceive cars as a safer mode of transport. This was evident during the previous summer as toll road traffic on French and Spanish toll roads were above 2019 levels during a few weeks. Furthermore, toll-road valuations are attractive. We are cautious on airports over the medium-term, and especially on those that are exposed to international long-haul, business and transfer traffic. We also remain positive on the outlook for railroads heading into 2022.

In summary, we have slightly shifted our portfolio towards companies that we believe will do better in an inflationary environment. However, 2/3rd of the portfolio remains invested in less GDP-sensitive sectors such as regulated utilities, towers and social infrastructure operators, which will likely still provide growth even in an economic downturn scenario. We continue to believe a balance between defensiveness and growth will be a better outcome for our Fund presently. The underlying portfolio companies, except airports due to the Covid-19 situation, continue to perform well from a fundamental point of view. Furthermore, a scenario of rising nominal rates is not a negative per se for Partners Group Listed Investments SICAV – Listed Infrastructure as more than two thirds of the portfolio companies' underlying revenues are directly or indirectly linked to inflation.

## ESG

We believe it is worthwhile highlighting that the Fund follows an ESG approach like all Partners Group products. Partners Group has been an early mover in ESG, as a UNPRI signatory since 2001 and with a dedicated ESG team that has been in place for many years. We have in the past and continue to decline certain investments purely on ESG concerns and the exclusion of power generation and in particular "dirty" coal fired power plants and "tail risky" nuclear power plants makes our Fund even further ESG relevant. We would also like to highlight that our Fund is rated 'AAA' – the highest possible rating – by the MSCI ESG platform.

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