



Listed infrastructure as a hedge against inflation

After close to a decade of low inflation, it would be understandable if investors have become complacent regarding the risks posed by inflation and the potential for long-term erosion of capital. But for how long can inflation remain at these historically low levels? Fiscal stimulus in the US, a recovery in the oil price; there are a number of potential risks that could trigger an increase in inflation.

So, where should investors look to insulate their portfolio from the impact of inflation? Listed infrastructure is a sector that has consistently achieved returns in excess of inflation while benefiting from directly or indirectly inflation linked cash flows. Partners Group, the global private markets investments manager, has been investing in private infrastructure on behalf of its clients since 2001 and launched a listed infrastructure strategy in October 2006, achieving annualised returns of 7.4%, an outperformance versus global equity markets of 1.1% per annum (Partner Group Listed Infrastructure EUR (I – Acc.) vs. MSCI World TR in EUR, as of 31 December 2017).

Inflation-linkage has been a component of this performance. We estimate that approx. two thirds of the fund's investments provide cash flows linked to inflation, either through long-term contracts, concessions or regulation. For example, water, electricity and gas utilities are regulated by governments, typically allowing companies to earn a real return on their regulated asset base.

Social infrastructure, including UK PFI projects which provide essential infrastructure such as schools and hospitals to the government, offer investors access to long-term, government-backed, inflation-linked cash flows. Even for companies in infrastructure sub-sectors with revenues which have no direct link to inflation (e.g. railways), but which have a monopolistic market position, gives these companies significant pricing power and the ability to increase prices often in line or above inflation, thus protecting the companies and their shareholders from the impact of rising costs and potentially discount rates.

It should be acknowledged that the liquidity and stock market listing of listed infrastructure companies means that returns can deviate over the short-term with equity market volatility. However, over the medium to long-term the compounding effect of long-term, inflation-linked revenues offers a powerful protection against the likely damage that inflation can have.

However, to capture these benefits investors must be selective. Regulation of similar assets can vary significantly between countries, while reference rates for inflation also differ. Two seemingly similar assets can offer very different return profiles in an inflationary environment. As ever, the devil is in the detail, and we advise investors to ensure they have a detailed understanding of the contracts, concessions or regulation affecting listed infrastructure companies in order to capture the benefits of the sector's inflation-protection.

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