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Q2 2021 Review

Partners Group Listed Investments SICAV – Listed Infrastructure

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2021 Q2 review

Q2 2021 has been another strong quarter for global equity markets, as they continued their positive run from Q4 last year. The positive performance has been driven by the increasing pace of vaccination campaigns, the easing of restrictions across most developed countries, as well as the continued favorable monetary policies both in Europe and the US. During the quarter, the growth outlook of many major economies has been revised upwards for 2021 and 2022, as manufacturing output and consumer spending quickly rebounded following the easing of COVID-19 restrictions and large government stimulus packages continue to support growth. Despite the improved growth outlook and increasing inflation, interest rates remain low in both the US and Europe.

In this environment, the Listed Infrastructure Fund performed very well, rising by more than 5% in Q2, posting positive performance in all three months of the quarter. The fund has outperformed the benchmark by 320bps during the quarter, fully recovering the underperformance of Q1, and remains well ahead of the benchmark on a YTD basis. Most of the outperformance was driven by communication infrastructure, primarily towers and datacenters, as well as toll roads, water utilities and transmission and distribution. All sectors in the portfolio contributed positively to performance, except for railways, which suffered from lower than expected volumes due to supply shortages.

In the communication sector, towers were particularly strong with Cellnex, American Tower and Crown Castle all returning more than 15%, on the back of faster 5G deployment and an acceleration of mobile network operators (MNO) capex spending. Cellnex performed particularly well, as the company successfully completed a EUR 7.0bn capital increase during April, which gives the company substantial firepower to execute on its EUR 18bn acquisition pipeline. Moreover, the company reported a 5.5% organic tenancy growth in Q1, the highest level in many years, and initiated a new cost cutting program. We have participated in the Cellnex equity issuance, further increasing our position in the company during the quarter. Datacenters also performed well during the quarter, with Equinix announcing an additional JV with GIC, the Singapore sovereign wealth fund, adding USD 3.9bn to expand the xScale data center program.

During the quarter, the transportation infrastructure sector continued to recover from the 2020 lows, but at a slower pace compared to the first quarter of the year. Toll roads were the best performing sector within transport, as traffic picked up quickly after the easing of COVID-19 restrictions. In many European countries, toll road traffic has nearly fully recovered (vs 2019 levels), a very positive sign for the sector. CCR, the Brazilian toll road operator, also performed well after its second largest shareholder sold its stake at a substantial premium to the current price. Additionally, CCR is likely to be among the main beneficiaries of the upcoming Brazilian auctions. Airports also continued to recover during the quarter, although traffic levels remain subdued, especially in Europe. Despite low traffic levels, an increase in airline bookings contributed to the optimism around the sector, expecting a more substantial recovery in the second part of the year. On the other hand, railways were the worst performer within the transport sector, as freight volumes were affected by supply chain constraints across many industries. Finally, Canadian National Railway was among the worst performers during the quarter, as the railway continues to pursue the acquisition of Kansas City Southern, viewed as expensive by the market.

After the strong performance during Q1, pipelines were broadly flat in Q2, as commodity prices continued to remain high on the back of a strong economic recovery. Within the sector, we continue to remain highly selective, investing only in operators with low commodity price exposure. Williams, the US gas pipeline operator, was among the best performers, as the company confirmed its 2021 financial targets. Regulated utilities continued to perform well during the quarter, also contributing to the fund outperformance. Chinese gas utilities, China Resources Gas and ENN Energy, were among the top performers, as there are rising expectations that gas sales volumes this year will be 20%+, higher than the initial guidance by management. Moreover, coal to gas conversion in the Chinese market is expected to continue to drive solid volume growth in the medium term. National Grid, the UK electric and gas utility, was also among the top performers, as the company reported solid full-year results. Management also published its five-year financial guidance, expecting 5-7% EPS CAGR, one of the highest growth profiles among European utilities.

Among other sectors, waste managers and regulated water operators continued to perform well. US waste managers continue to be supported by increasing waste volumes, a favorable pricing environment, as well as accretive bolt-on M&A activity. The US water operator American Water reaffirmed its mid-term earnings and RAB guidance and continues to execute on its large capex program, which had a positive impact on the performance. Social infrastructure operators were also slightly up during the month.

Though regulated utilities remain the largest allocation in the portfolio currently, we have been increasing exposure to towers and toll roads, as well as reducing the cash allocation in the fund this year. Other sectors where we have also increased exposure are renewables, waste managers and data center REITs. While, we do not believe that the risks associated with COVID-19 have abated, we did find more opportunities to invest across our universe in H1 2021, after the weak performance last year.

Communications infrastructure remains one of our key sectors in 2021, 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 centers are also expected to benefit from such long-term secular trends. We have been increasing our position in communication infrastructure throughout Q4 last year and in H1 2021, which has supported the strong performance of the fund throughout the second quarter of the year.

We continue to see a few investment opportunities among regulated utilities. Share performance for the sector overall has been flat or slightly positive over the past 18-24 months, while underlying earnings growth remains 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 since the summer last year. Finally, while transport recovered sharply in Q4 last year following news about the vaccines, it has again weakened in June 2021, following the spread of the delta-variant of the virus. Airports have been especially impacted, while toll road traffic continues to show much more resilience, as we had anticipated. 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 already evident in May 2021 when toll road traffic on French toll roads almost recovered to 2019 levels during a few weeks. Furthermore, toll-road valuations are attractive and the Brazilian toll roads may also benefit from operating new concessions. We are cautious on airports over the medium-term, and especially on those that are exposed to international long-haul or transfer traffic. We have maintained our high allocation to the railroads, and we may consider increasing railroads further when valuations become attractive.

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

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