Partners Group
REALIZING POTENTIAL IN PRIVATE MARKETS

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Q2 2022 Review

Partners Group Listed Investments SICAV – Listed Infrastructure

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Disclaimer

2022 Q2 review

Key market drivers

The uncertainty and volatility in global equity markets continued in Q2 2022, with the markets declining further after the weak performance in Q1. The rise in inflation, as well as the war in Ukraine, which has driven up energy prices globally, have been two significant factors for the market weakness seen in 2022. Economic data in both the US and Europe came in weaker than expected, with Eurozone PMI readings falling to the lowest level since February 2021. However, the US labor market has remained tight, which further raises the risk of a wages-driven inflation, and worryingly, the consumer credit in the country has risen to record highs of over USD 50 billion. Overall, the economic sentiment was weak during Q2, and the IMF slashed its growth forecast for 2022, especially for the US and for Eurozone.

While US stocks recorded their worst first half of the year for over 50 years, the Partners Group Listed Investments SICAV – Listed Infrastructure has been much more stable and defensive during this period, falling by -1.6%, compared to the broader market indices - MSCI World (-13%) and the S&P 500 (-21%). 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 largely negative, with regulated utilities the clear outlier during the quarter having delivered a positive return in this period. Regionally, North American and European equities were weak, while Chinese equities delivered a positive return, helped by the reopening of a few cities following Covid-related lockdowns.

Key portfolio drivers

Within transportation infrastructure, railroads and airports contributed negatively to the performance during the quarter. European airport operators such as Aena, ADP and Flughafen Zurich performed weakly during Q2 despite traffic forecast for 2022 being raised. The airports struggled with rising inflation, workers' strikes leading to cancelled flights, as well as an uptick in covid cases across Europe. The European airports are struggling to manage a resumption of travel among passengers, with reduced manpower and lower capacity, which they reduced during Covid pandemic and have not ramped up sufficiently. The North American railroads, especially Union Pacific and CSX, were also weak during the quarter as freight transport infrastructure overall has had a poor beginning to the year. However, railroads have generally been considered more economically resilient due to their strong competitive advantage compared to trucks, and in May, the sector shed some value as investors recycled into other transport infrastructure, including logistics. While not immune to cycles, we believe that railroads will retain their strong pricing power relative to other forms of freight transport. Toll roads, on the other hand, performed relatively well as both Atlantia and Transurban were the top two performing companies in the portfolio in Q2. Atlantia received a take-private offer from its largest shareholder, the Benetton Family, in a consortium with Blackstone. The offer came shortly after Atlantia finalized the disposal of ASPI, its Italian toll road subsidiary, and was at approximatively 25% premium to the unaffected share price. Transurban performance was driven by a continued improvement in traffic on its toll roads.

Communication infrastructure declined further in Q2 with some company-specific news affecting the sector. Cellnex, the Spanish tower operator, decreased in value early in the quarter after news emerged that it would make an acquisition bid for the Deutsche Telecom tower assets that could be valued as highly as over USD 20 billion. Investors were concerned that Cellnex will need to issue more shares since its current leverage will not allow for such a large acquisition financed only by debt, even if Cellnex were to choose to partner with another firm for the bid. Equinix, the data center operator, also performed weakly during the quarter due to concerns regarding the competition which data centers might face from hyperscale cloud companies, that could impact their growth outlook. American Tower, on the other hand, delivered a modest positive return as it announced a joint venture for the Coresite acquisition, so it would need to raise less from an equity issuance planned later this year.

Within energy and utilities, the regulated utilities were the clear outlier in terms of performance with a positive return for the quarter. The Chinese gas distributors' equities such as ENN Energy and China Resources had a strong quarter, with performance largely driven by the easing of lockdown restrictions in China, which is likely to support gas demand especially from commercial and industrial customers. Regulated utilities also benefitted from a rotation into more defensive sectors compared to the cyclical sectors during the quarter, though there was little company-specific news. The regulated utilities have remained largely unaffected by the pandemic and are continuing to deliver on their investment plans, despite rising inflation and geopolitical events. The energy pipelines sector shed some gains in Q2 as oil prices declined and the risk of a recession increased. The energy pipelines have reported strong financial results for Q1, and many continue to trade at over 5% dividend yield, but they can be highly correlated to energy prices, as we have seen this year. The water and waste sectors were flat during the quarter, with little company-specific news.

Finally, social infrastructure was modestly negative during the quarter, but continued to provide stability to the portfolio.

Portfolio positioning and outlook

Though regulated utilities are the second 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. Other sectors where we have also increased exposure are waste managers and data centers. During the pandemic, we found that certain companies offered compelling valuations for us to consider increasing them. In the past quarter, we made limited changes at the beginning of the quarter, with an increase in toll roads –Ferrovial and Transurban – and a decrease in airports stocks such as Aena and Atlantia (following the take-private offer).

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 Mobile Network Operators (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 H1, we find that underlying fundamentals and leasing activity all remain robust.

Regulated utilities have performed relatively well in 2022 YTD, but we continue to see good opportunities within this sub-sector. Share performance for the sector overall had been relatively modest over the past 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.

In summary, we have slightly shifted our portfolio towards companies that we believe will do better in an inflationary environment. However, two thirds of the portfolio remain 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. Except airports, the underlying portfolio companies continue to perform well from a fundamental point of view. Furthermore, a scenario of rising nominal rates is not negative per se for the Fund 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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