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Q4 2021 Review

Partners Group Listed Investments SICAV – Listed Infrastructure

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2021 Q4 review

Key market drivers

After a volatile Q3, globally equity markets recovered strongly in Q4 2021 to cap off an overall strong year. While the performance recovery had already begun in October led by robust Q3 results, the month of November saw some weakness as concerns grew over the new Covid-19 variant, Omicron . However, equity markets largely shrugged those concerns as the variant so far has proven to be less lethal – in terms of hospitalizations and number of deaths – and rose strongly in December. Furthermore, healthy employment data was reported in the US, though rising inflation in Q4 remained an emerging threat, and there are indications that the US Fed and the ECB are likely to increase rates as early as Q1 2022.

The Partners Group Listed Investments SICAV – Listed Infrastructure grew very strongly in Q4, rising by over 8.5%, and outperformed its benchmark (6.6%). The fund reclaimed its 2021 outperformance over the benchmark, which it had previously lost at the end of Q3. In 2021 and for the second consecutive year, the Fund outperformed its benchmark. All infrastructure subsectors contributed positively during the year, showing resilient fundamentals with the only exception of airports. The fund relative outperformance was primarily driven by its high allocation to towers, regulated transmission & distribution utilities, railroads and waste managers, and despite the relatively lower allocation to energy pipelines, which was the strongest performing infrastructure subsector in 2021.

Key portfolio drivers

The transportation infrastructure sector performance in Q4 was bifurcated, as railroads rose strongly while airports were weak, driven largely by concerns over the Omicron variant. The performance of toll road operators was muted during the quarter. Within railroads, Union Pacific ("UNP") – the largest listed North American railroad operator – was the strongest performer during the quarter as it posted robust Q3 results. During the quarter, the company also provided a positive update that it will increase capacity, including taking on extra carloads over the weekends to ease congestion across the US West Coast ports. Rumo – the Brazilian railway operator – also had a strong quarter as the outlook for 2022 harvest is strong, which will support volumes. On the other hand, CCR – the Brazilian toll road operator – was one of the weakest performers during the quarter driven mainly by macro concerns of slowing growth and rising inflation.

Communication infrastructure recovered well from the weakness in Q3, as both towers and data centers delivered a positive return in Q4. There was limited news flow on the US towers, but Crown Castle ("CCI") performed strongly, supported by expectations of higher MNO capex in 2022, leading to higher tower leasing activity. There are also growing indicators that edge infrastructure may turn out to be another long-term growth driver for tower operators, although still in early stages. The Spanish tower operator Cellnex, on the other hand, was a weak performer in the quarter as the UK Competition and Markets Authority raised concerns over its acquisition of the tower portfolio of CK Hutchsion. A final decision is only expected by March 2022 and we expect the shares to suffer from overhang and uncertainty until then.

The regulated transmission and distribution sector was the strongest contributor to the Fund's performance in Q4. The waste managers and the water utilities also performed very strongly in Q4, while the pipelines had a relatively flattish quarter. Within regulated utilities, Atmos Energy recovered strongly in December after a weak start to the year. Lower US natural gas prices in December helped to ease investor concerns over high utility bills and a potential reduction in the capex program. The shares continue to trade at lower multiples compared to the utilities sector, despite a solid EPS growth outlook. The US waste disposal provider Republic Services ("RSG") was another strong performer during the quarter, driven by solid Q3 results and the company also increased guidance for 2021. Encouragingly, RSG also posted its highest ever M&A activity in any year, indicating strong appetite for consolidation in a largely fragmented industry, with further increase expected in 2022. Core pricing increase was also comfortably above inflation. Within energy pipelines, the North American company TC Energy was the weakest as crude oil prices saw their first big correction of the year in November, falling 20%. Though TC Energy reported in-line Q3 results, an unexpected downward revision of dividend growth target was disappointing.

Social infrastructure operators rose during the quarter, also contributing to the fund's performance.

Portfolio positioning and outlook

Though regulated utilities remain the largest allocation in the portfolio currently, we have been increasing exposure to towers, toll roads and railroads, as well as reducing the cash allocation in the fund this year. 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 the allocation to them. In the past quarter, we divested two positions – Sydney Airport and One Gas – while adding to the Chinese gas distributors as well as to CMS Energy. We divested Sydney Airport after the share price had risen sharply to trade close to the acquisition price made by a consortium of Australian institutions, while we increased the Chinese gas distributors after the weakness in the share prices in the previous quarter.

Communications infrastructure remains 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 has supported the strong performance of the fund last year. We also subscribed to the Cellnex rights issue in April.

We continue to see a few investment opportunities among regulated utilities. Share performance for the sector overall has been 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 of 2020. 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 more GDP-sensitive sectors, such as toll roads and railroads, 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 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 Covid19 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 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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