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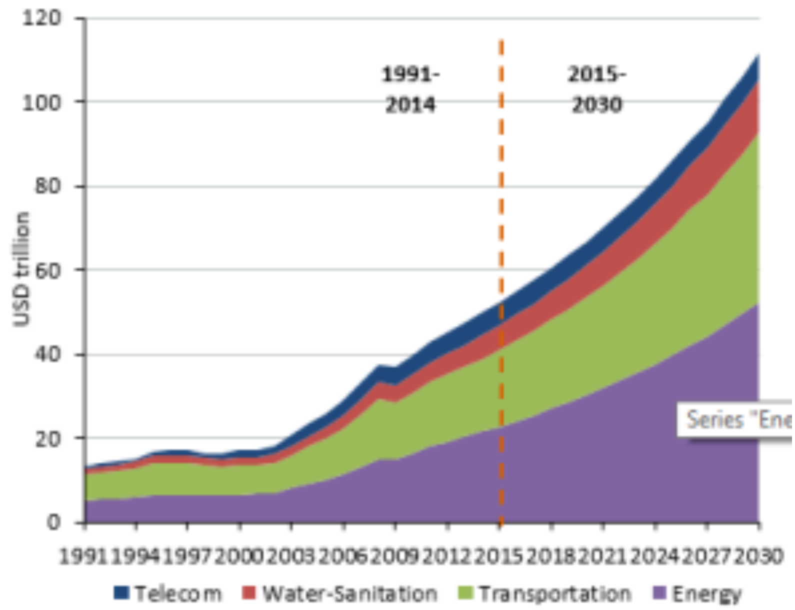
How is infrastructure expected to perform in the future?

Infrastructure has been an impressive growth story to date.
But what can investors expect from the asset class in the future? Will it continue to grow or should advisers be preparing their clients for a slowdown and therefore lower returns?
To understand more about the asset class, it helps to look at where growth has come from in the past.
Peter Meany, portfolio manager, First State Global Listed Infrastructure fund, says a number of economic and demographic shifts have driven the growing need for infrastructure.
Most people are aware of the need for more buildings, such as schools and hospitals in the UK and other developed markets, as well as the role infrastructure can play in updating and maintaining infrastructure.
>The global stock of infrastructure assets is set to expand greatly over the coming years.---Nick Langley
In emerging markets, the need is for far more basic infrastructure, such as roads and bridges.
Mr Meany explains: “Structural themes including urban congestion, globalisation of trade, evolving energy markets, and mobility of communications have placed enormous strain upon existing infrastructure networks, many of which now require replacement cycle or additional investment over many decades.
“In recent years, investors have increasingly recognised that these assets - backed by the right business model - have the potential to deliver attractive long-term returns.”
He notes: “These themes have coincided with an expansion of the listed infrastructure investment universe, due to corporate restructurings and government privatisations.”
Going for growth
Today, infrastructure is an asset class in a multi-decade secular growth phase, according to Nick Langley, co-chief executive officer and co-chief investment officer at RARE Infrastructure, a Legg Mason affiliate.
“Estimates vary; however they all point in the same direction – the global stock of infrastructure assets is set to expand greatly over the coming years,” he forecasts.
“One set of calculations produced by a leading economic think tank [David Hale Global Economics, 2014] estimates the global stock of infrastructure doubling to more than $110trn over the next 15 years.”
Figure 1: The expected growth in the value of global infrastructure assets by sector



Source: David Hale Global Economics (2014) and RARE, as at 31 December 2014

He predicts the expansion in infrastructure stock will be driven by both developed and emerging markets, as it has been in the past.

In developed markets, this will take the form of bringing existing infrastructure up to a standard that meets current needs, he observes.

There will also be a significant amount of investment required to fund infrastructure which meets the future needs in developed countries, including the UK.

William Argent of Gravis Capital Management, fund adviser to the VT UK Infrastructure Income fund, points out: “In 2016 the British government announced plans to spend more than £500bn, in conjunction with the private sector, on infrastructure investments identified in its National Infrastructure and Construction Pipeline.

“Almost £300bn is set to be invested by 2021, providing clear support for the sector to expand. Although a wide range of social and economic projects will be targeted, the initial phase will see the bulk of investment being focused on the energy and transport sectors.”

Typically, infrastructure projects have more recently been relying on private funding rather than public finances to get developments off the ground.

>Economic development and the integration of emerging markets into the global economy will require extensive infrastructure investment.---Peter Meany

This was not always the case.

Mr Langley recalls: “While the public sector dominated the infrastructure landscape until the latter stages of the 20th century, with governments planning, building, and operating the vast majority of infrastructure assets around the world, this started to change in the 1980s.

“In this period we saw policy changes (led in part by the UK) transferring infrastructure assets to the private sector, and highlighting the growing importance of markets to provide financing. In the following 30 years we have seen billions of assets sold to the private sector, which has operated, maintained, and developed them.”

He continues: “When we then step forward to today, we find ourselves in a position where government debt has ballooned across the world, and many governments simply don’t have the budget or appetite to fund infrastructure projects.”

Higher or lower?

The opportunity here then is for increasing private sector involvement, not just in the UK and US but also further afield.

Mr Meany suggests: “A number of other drivers are likely to support further growth for the listed infrastructure asset class over coming years. Economic development and the integration of emerging markets into the global economy will require extensive infrastructure investment.

“China’s ‘One Belt, One Road’ development strategy has the potential to deliver significant infrastructure investments across Eurasia and Africa. We also expect renewable energy and battery storage investment will continue to grow over the next decade, albeit at a slower rate due to the law of large numbers and a gradual reduction in subsidy levels.”

What is China’s One Belt One Road policy?

David Jane, manager of Miton’s multi-asset fund range, explains: “Little talked about in the West, where China’s military ambitions and naval exploits in the South China Sea are seemingly of more interest, the One Belt One Road programme is perhaps the most significant policy of the Chinese regime. Currently, China’s only route to global markets is via the South China Sea. This is seen as being controlled by foreign powers, Japan and the US, who while not hostile are clearly not allies. Having another route via Central Asia is a key priority for the Chinese. The policy, however, goes far beyond the desire for an alternative route to the European markets, it’s also about pan-regional development. This is where the excess savings and China’s huge experience in rapid infrastructure development come into play.

“Much of the policy concerns building transport infrastructure in the near [term]. In the longer term, it will no doubt stimulate economic development throughout the region, creating a new market for Chinese exports but also broadening the Chinese sphere of influence at a time when US influence is arguably in decline. Another benefit will be that it can offer an alternative, and more worthwhile, outlet for Chinese excess savings, rather than gambling, stockmarket bubbles and housing speculation domestically and in London.”

But Gavin Haynes, managing director at Whitechurch Securities, believes investors should brace themselves for lower returns from the asset class.

“Going forward, we do not expect to see the levels of returns achieved over the past five years based on current valuations,” he warns.

“Higher bond yields could prove to be a headwind and we believe that it will be important for managers to be selective and move away from expensive bond proxy areas to seek value.

“In an uncertain political backdrop, the risk of regulatory interference could also weigh on utilities.”

However, he acknowledges this does not mean advisers’ clients should be selling out of the asset class.

“We still believe that well diversified exposure to infrastructure, both globally and by sector, can provide attractive, income-focused returns,” he adds.

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