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What advantages and opportunities does the asset class provide?

A number of characteristics have helped infrastructure become a useful allocation in investors' portfolios.
There is the inflation linkage aspect, as mentioned earlier in this guide, which in an inflationary environment is even more appealing.
Infrastructure also has an income element to it which, when other more traditional asset classes are struggling to meet investors' income needs, makes it very attractive.
Then there's the fact it adds another layer of diversification to a client's portfolio.
The asset class seems to tick all the boxes, with both growth and income investors benefiting from exposure to infrastructure.
Insulated from inflation
Peter Meany, portfolio manager, First State Global Listed Infrastructure fund, points out: "One of the key benefits of listed infrastructure is its ability to insulate investors from the effects of inflation.
"Our companies' regulated or contracted agreements allow them to increase prices by inflation. This price increase is borne by customers. It makes the company more profitable so it's beneficial for shareholders.
"Many infrastructure assets, including utilities and toll roads, have explicit links to inflation through regulation, concession agreements or long-term contracts.
"Other assets without an explicit link, such as US freight railroads or mobile towers, often have the pricing power to deliver a similar (or better) outcome, reflecting their strong strategic positions."
>For many the asset class is viewed as an alternative to investing in the debt markets in the prevailing environment of very low interest rates.---William Argent
Adam Burniston, model portfolio manager at Thesis Asset Management, gives an example of how this inflation protection works.
"INPP, one of our primary infrastructure exposures, has an inflation 'linkage' of 89 per cent (the highest in the peer group) - that is to say that for every 1 per cent of inflation in the economy, INPP's revenues grow by 0.89 per cent," he says.
"This is a good starting point on which to develop a growing revenue stream."
Nick Langley, co-chief executive officer and co-chief investment officer at RARE Infrastructure, a Legg Mason affiliate, estimates more than 80 per cent of the cashflows of companies in which the Legg Mason IF RARE Global Infrastructure Income fund invests are either directly or indirectly linked to inflation.
But it's not just that infrastructure provides a form of protection against rising inflation.
The asset class also has a stable risk return profile, as Mr Langley explains.
"As infrastructure companies are typically involved in the provision of an essential service (often over a long time period), backed by hard assets, while having a degree of price certainty (a regulatory framework or long-term contract), we see the risk/return profiles on offer in the sector being very

stable over time.
“While any return will involve some degree of risk, the nature of the asset class means that skilled investors can potentially achieve a return that more than compensates for the risk incurred,” he notes.
William Argent of Gravis Capital Management, fund adviser to the VT UK Infrastructure Income fund, agrees the relatively low-risk nature of the typical social infrastructure project has resulted in stable asset valuations, with investors experiencing low volatility in the value of their capital.
“These characteristics are attractive to investors and for many the asset class is viewed as an alternative to investing in the debt markets in the prevailing environment of very low interest rates."

Recurring dividends

Income is usually high up a client’s list of priorities when it comes to reasons for investing, particularly if they are planning for retirement.
More often than not, UK investors rely on dividends, so often may invest in an equity income fund, for this element of their portfolio.
But infrastructure has a good track record of generating income, at a time when traditional sources such as fixed income are not generating decent yields.
Mr Burniston believes: “In an environment of ultra-low bond yields, compressed and highly-valued property rents, the type of income produced by infrastructure has been extremely popular.”
According to Annabel Brodie-Smith, communications director at the Association of Investment Companies (AIC), the AIC Sector Specialist: Infrastructure sector is also a popular sector among income-seeking investors.
“With the sector having a dividend yield of almost 5 per cent, it’s not hard to see why,” she adds.
As Mr Langley notes, not only does it provide an income stream but the dividends paid out by infrastructure should be growing and recurring over time.

Reasons to invest in infrastructure

There are a number of compelling reasons to consider investing in infrastructure, says Whitechurch Securities managing director Gavin Haynes. He lists the following:

Income generation – Infrastructure assets tend to be cash generative and so produce regular, stable income distributions – an attractive prospect in this lower for longer interest rate environment - and this has been a key driver in the increased desirability of the sector.

Resilience to the economic cycle – Infrastructure projects are generally used to provide vital services, which means they are resilient and stable during periods of economic downturns. This non-cyclical element has been sought after in a climate of low global growth.

Inflation hedge – At a time when inflationary pressures are once again concerning investors, revenues from certain infrastructure assets (such as toll roads) are often inflation linked, either through a regulatory framework or contractual obligations.

High barriers to entry - Projects typically require significant capital investment and have long lead-in times, which create barriers to entry for new competitors.

Defensive attributes - Infrastructure assets are generally long-dated assets and so are typically lower risk than broader equity markets and relatively defensive during periods of equity market weakness.

Government underpin – A high degree of private sector infrastructure spend generates revenue from long-term contracts with the public sector or public sector-backed clients. This provides security to the asset class' income streams.

One of the other main advantages of the asset class is its ability to act as a diversifier in portfolios as it has a lower correlation to other assets, including equities and bonds.

He explains: "This is a result of the underlying return streams of infrastructure companies being strongly linked to the regulatory or contractual frameworks in place, rather than typical drivers of equity and bond returns.

"More importantly, we frequently see this diversification benefit increase in times of market stress, meaning that infrastructure provides protection through diversification exactly when it is needed the most."

As such, an infrastructure holding, whether it's an investment trust or open-ended fund, can be an attribute to a portfolio of wider investments.

"The drivers of infrastructure earnings tend to be structural rather than cyclical," Mr Meany acknowledges. "This enables them to generate resilient and growing earnings streams and makes them relatively immune to economic cycles."

Mr Meany adds: "For example, mobile towers are benefiting from growth in demand for mobile data and the resulting need for telecom operators to upgrade and infill their networks.

"The North American shale energy revolution has driven the need for new oil and gas pipeline networks, as well as storage and export infrastructure.

"A relatively low correlation with other asset classes also enables listed infrastructure to provide diversification benefits to an investment portfolio."

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