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Home and away: where to go for infrastructure assets

With much emphasis from politicians in the UK and President Donald Trump in the US on boosting infrastructure spend, it might seem there are plenty of opportunities in developed markets.

But where should investors be heading for their infrastructure exposure? The high-growth emerging markets?

Or perhaps the relatively lower-risk and measurable UK market – ignoring warnings against home bias?

Then again, perhaps people should head to the US, where there have been pledges to boost infrastructure and construction, but where expected projects might not actually come to fruition?

Domestic market

Many UK investors prefer to remain in the home market, where the infrastructure spend of the UK is more measureable and quantifiable.

Mar Beltran, senior director and infrastructure sector lead for Europe, the Middle East and Africa in the infrastructure ratings division of S&P Global Ratings, says this trend is clear.

>Investors will benefit from having exposure to a portfolio of infrastructure assets diversified by geographic location. --- William Argent

“Institutional investors in unlisted infrastructure maintain a strong preference for domestic investment opportunities,” he avers.

“This is due to the complexity of the investment: co-ordinating the right network of political and business contacts can take time.”

For William Argent, fund manager for Gravis Capital Management and fund adviser to the VT UK Infrastructure Income fund, the domestic market is a good starting point, but there has been a rush of money into UK infrastructure assets recently.

As a result, he believes the high demand has driven valuations up and pushed implied returns lower.

According to Mr Argent: “This trend has been particularly acute within the UK and some infrastructure companies have responded by increasing their allocations to overseas assets, where better returns may be achieved.

“Investors will benefit from having exposure to a portfolio of infrastructure assets diversified by geographic location.”

However, he adds, investors can achieve this without having to purchase infrastructure companies listed overseas, either by investing in UK companies that derive the bulk of their revenue from overseas operations, or by investing in a UK-listed investment trust that invests in global infrastructure assets, for example.

Mr Beltran agrees: “Managers in listed infrastructure are commonly positioned in global stocks. In essence, it’s all about size: to get capital markets exposure, having global investors is key.”

He also says investors in America are less biased to their home markets than European investors tend to be: “From our perspective, North America-based investors seem more interested in exposure to global infrastructure markets than investors in Europe and Asia."

Other developed markets

President Trump's declaration back in January this year of a huge infrastructure spend filled the market with good feelings about what this means for real assets in the US market.

Infrastructure stocks and funds were said at the time to be the main beneficiaries of such promised capital expenditure, with billions of US dollars set aside for key projects.

In February, President Trump told a group of governors gathered at the White House: "Infrastructure – we're going to start spending on infrastructure big. Not like we have a choice. It's not like, oh gee, let's hold it off."

Europe also presents some compelling medium to long-term investment opportunities.

If you think the roads in Britain need some serious TLC, just think of the billions now being put towards fixing Germany's motorways.

A recent S&P Global ratings report from March reported Germany has fallen to 16 from 4th place in the World Economic Forum's world rankings of infrastructure investment.

This is largely because it hasn't upgraded its road infrastructure and fixing this is likely to run into billions and will present a compelling investment opportunity. Likewise, it will need to boost its investment in renewable energy and improve its digital infrastructure.

That said, with a high current account surplus of 8.6 per cent as at 31 December 2016, Germany's government has enough funds to put towards infrastructure projects without having to go to a third party – the private sector.

Emerging markets

Ten years ago, the biggest infrastructure spend was coming from two of the BRIC countries – the 'India' and 'China' of that acronym.

Billions of dollars were being thrown into developing cities and transport systems to bolster their burgeoning economies.

India's infrastructure spend is approximately 5 per cent of its GDP, and China in particular has been continuing to spend. Estimates put its infrastructure spend at approximately 6.8 per cent of its GDP.

A McKinsey & Co commentary in January this year predicted the country would continue to carry out its planned infrastructure projects.

The commentary said: "The government hasn't run out of good (or bad) infrastructure projects to spend on.

"Everything from urban transit – such as the $36bn (£26.4bn) project to create a megacity by improving transport links among Beijing, Tianjin, and the neighbouring province of Hebei – to intercity rail, water treatment, and 5G projects.

"Collectively, these projects could deliver several percentage points of growth in a manner similar to a decade ago, but not without debt levels reaching 300 per cent of GDP by the end of the year."

>There are significant opportunities available overseas, and therefore investors should not restrict infrastructure holdings to one or even a handful of countries. --- Nick Langley

But China is not the only fruit in the infrastructure basket. Other emerging markets are arising.

For example, Andy Ho, chief investment officer at VinaCapital and managing director of the VinaCapital Vietnam Opportunity Fund, comments: “There is a tremendous push to build infrastructure in Vietnam, and there are a number of local companies experienced in seeing these kind of projects through.”

Asia certainly seems to be popular. The Asian Development Bank (ADB) has estimated that developing Asia will require approximately $22 trillion (£16.1trn) in infrastructure spend from 2016 to 2030, just to keep pace with economic growth.

Diversification

For Mr Ho, every single country is different, so infrastructure investment very much tends to be a local issue, with “each country having different cultures, laws, ways of doing business, and so on”.

Yet all have some form of infrastructure development. Collins Roth, managing director at MPC Industrial Projects, states: “Almost every market in the world would benefit from greater infrastructure spending.

“Even China, which has put massive amounts of capital to work, still needs more investment.”

As a result, diversification is needed to get access to various growth and income potential.

James Smith, portfolio manager at Premier Asset Management, comments: “Different investments will be suitable for different investors, but we believe a globally diversified approach to infrastructure investing makes a lot of sense.

“This is partly because one of the major risks in infrastructure can be political, but also because the opportunities for finding good income and growth investments in infrastructure assets are global.”

According to Nick Langley, co-chief executive and co-chief investment officer at RARE Infrastructure, a Legg Mason affiliate, investors should hold both domestic UK and global stocks.

“There are significant opportunities available overseas, and therefore investors should not restrict infrastructure holdings to one or even a handful of countries.”

Within the Legg Mason IF RARE Global Infrastructure Income fund, he says there is a global mix of user pay and regulated assets.

“The characteristics of each region, including the strength and stability of regulation within them, dictate the extent to which we hold assets within them, and the split between regulated assets and user pay assets.”

Mr Roth adds: “We believe global exposure, including emerging markets, is an interesting option for large investors seeking portfolio diversity.

“Global exposure can add uncorrelated performance to a portfolio by taking exposure to GDP outside of a home market, but without taking full market, consumer or brand risk. It’s a question of risk tolerance.”

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