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RARE Infrastructure

Building sustainable, growing income

In times of uncertainty, investing in infrastructure might just be the perfect play.

As the saying goes, you often don't realise what you've got until it's gone.

Never has this theory been more apt, as nations around the world have locked down in an attempt to flatten the curve and stave off the spread of COVID-19.

Another concept that has risen to the fore in all the uncertainty is that of essentiality, particularly essential services.

This is what RARE Infrastructure deals in.

Founded in 2006, RARE specialises in investing in the physical assets that provide an essential service to society.

Now, some of these have certainly not been immune to the ongoing market volatility – think airports and toll roads.

"The current environment is certainly volatile and uncertain and what we've seen is a lot of indiscriminate selling, it's fair to say that infrastructure has also suffered as a result," RARE Infrastructure senior portfolio manager Charles Hamieh[01] says.

"What we are confident in however, is the fundamental, long-term value of the asset class."

And the good news is that there are plenty of essential services that stand to gain from the virus-induced shutdown.

RARE ensures diversification by investing in both user-pays and regulated assets.

For context, user-pays assets are those that move people, goods and services throughout an economy and, as the name suggests, are paid for by the user. This can include airports, toll roads, rail networks and telecommunications towers.

In contrast, regulated assets are those whereby the price is set by the regulator and if a service provider earns more revenues than the regulator allows, those revenues are then passed back to the customers by way of cheaper pricing. Water, electricity and gas transmission and distribution all sit within this category.

Because these assets provide an essential service to the economy, they in turn provide very predictable and resilient cashflows, Hamieh says.

"And that generally translates into very predictable dividends which typically grow well above inflation," he adds.

RARE's investment process is designed to leverage the observation that, over time, asset valuations reflect long-term cash flows. As a result, RARE focuses on the infrastructure assets that display more predictable cash flows.

Therefore, with traditional sources of income such as cash and bond yields declining sharply over recent years due to very – now historically – low interest rates, and a weakening economy placing pressure on many companies, the income provided by infrastructure investments is understandably attractive.

And despite the scale of the assets RARE invests in, ESG and ensuring the investments are sustainable is always top of mind.

ESG has been a pillar of the RARE process since inception, Hamieh explains, with the firm having been a signatory to the United Nation's Principles of Responsible Investment since 2010.

This is because RARE believes ESG will likely be a key driver for the infrastructure sector going forward. This is evidenced by governments setting targets for electricity sourced from renewable energy and the increasing amount of capital being spent to mitigate the effects of climate change, to make infrastructure more resilient to major climate events and to increase efficiency.

Playing its part, when selecting and monitoring its investments RARE considers ESG in three key areas.

The first looks at the cashflows of a company, specifically the opportunities that companies are presented with.

"For example, an electricity utility may invest significant amounts of capital expenditure in renewable energy and earn a return for a long period of time on that expenditure," Hamieh explains.

The second component RARE looks at is the required return of a company.

"As it relates to required returns, we are looking at how companies' ESG profile fits into the broader universe," Hamieh says.

"This means we are penalising companies that are underachieving and rewarding those that are overachieving."

Finally, the third means by which RARE ensures its own ESG and sustainable investment standards are being adhered to is via its engagement with all entities involved in an investment.

"We engage with companies frequently, but it's not only companies. We also engage with other stakeholders whether it be regulators, governments or independent experts," Hamieh explains.

This process is undertaken for all RARE's offerings, including the RARE Infrastructure Income Fund.

The RARE Infrastructure Income Fund aims to provide investors with long-term inflation-linked capital growth over an economic cycle to deliver reliable income.

The strategy invests in a range of listed infrastructure securities and sub-sectors across both developed and emerging markets, targeting a 5% dividend yield to investors.

"It seeks to achieve that by investing in the more defensive parts of the infrastructure universe, such as water, gas and electricity and transmission," Hamieh explains.

"These companies are more defensive because they provide an essential service, meaning you have more resilient cashflows making your dividend yield typically higher than with the more user-pays, cyclical parts of the universe."

Since its inception in September 2008, to date, the RARE Infrastructure Income Fund has returned 10.4%, net of fees.

In addition, the performance history of the Fund shows that it has played a defensive role in periods where the MSCI AC World equity market has sold off sharply. In the most recent quarter, Q1 2020, the equity market fell 20%, and the RARE Infrastructure Income Fund fell a little over 12%. During Q4 2018, when global equities were down more than 12%, the RARE Infrastructure Income Fund was actually up.

Both Lonsec and Zenith rate the Fund as 'Recommended', while SQM Research deemed it to be 'Superior'.

It therefore makes sense the RARE Infrastructure Income Fund has recently been made available on several platforms, including Macquarie and Netwealth.

And it couldn't come at a better time, as investors increasingly seek to position their portfolios more defensively to protect against ongoing market turmoil while simultaneously searching for an alternative to fixed interest and cash.

For Australian investors, RARE says it's also important to note that global listed infrastructure stocks have a low correlation to the Australian dollar, domestic equities and global bonds, making them an ideal vehicle for diversification.

"We think financial advisers will find this fund very attractive, as will self-managed super fund trustees, as it is clearly differentiated from other income options in the market," Hamieh explains.

"Most importantly, it has a long-term track record of consistently delivering on that 5% dividend and total return target." FS

The quote

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Watch the video on www.fsitv.com