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RARE Infrastructure

Invest in infrastructure for a reliable income

The bond market is signalling concerns about a possible recession, with the yield curve "inverting" for the first time since 2007, sending ripples through financial markets globally. This warning signal comes amid rising tensions culminating from the US-China trade war, increasing market volatility, and a global economic slowdown. While an inverted yield curve is only one key indicator and the general view is that a recession is not yet in sight, there is a growing consensus that we are now in the late stages of the economic cycle.

In this environment, investors need to navigate market volatility more carefully and be more selective with their investment decisions. Global listed infrastructure is known for its defensive characteristics and resilience during turbulent equity markets, which may suggest why advisers are currently increasing their allocations to this sector. Furthermore, infrastructure companies can provide more predictable cash flow and attractive dividends, even during periods of slowdown or recession.

As the business cycle further matures, we are of the view that quality assets that deliver growing earnings will be sought after and attract more capital, as investors become more defensively positioned. As demonstrated by the graph below, listed infrastructure is less likely to be impacted during declining equity markets.

While stock prices of these companies may be affected by broad market sell-offs, their resilient earnings and cash flow profile gives RARE confidence that the stock price will bounce back and in the meantime, they will benefit their investors by continuing to pay healthy dividends.

Where loss aversion is a key driver, specialist listed infrastructure portfolios such as the RARE Infrastructure Income Strategy can further limit the impact of economic downturns. This is achieved through a defensive strategy, which consists predominantly of utility companies that deliver more predictable income distributions due to stable earnings derived from the underlying asset. Regulation and long-term contracts generally offer stable cash flow and greater capital stability. For investors, this can provide excellent visibility over revenues and dividends.

Notably, the RARE Income Strategy has seen a 65% upside capture of monthly gains made by the MSCI AC World Index while bearing only 26% of any overall monthly losses of the same index since 2010.

As we head into the late stages of the economic cycle, investors can better protect themselves by increasing their defensive equity exposure through infrastructure stocks while still remaining invested.

Furthermore, given the current low rate environement, listed infrastructure is a becoming an increasingly popular income solution for many investors. This is due to its track record of consistently delivering a higher yield compared to global equities and 10-year bonds. When creating listed infrastructure income portfolios, we consider the following fundamentals.

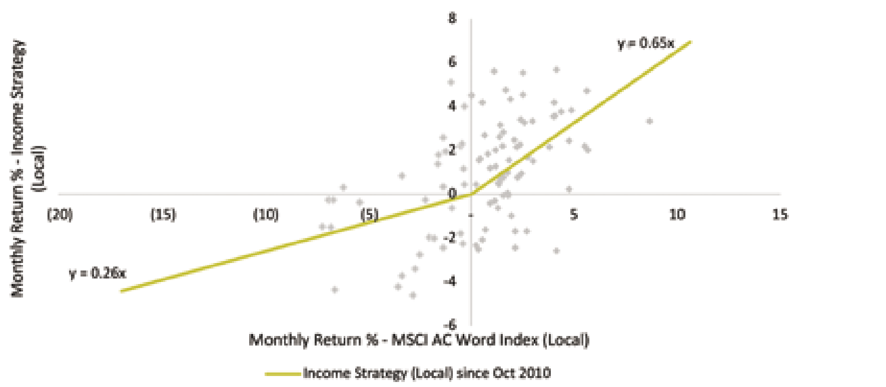
Firstly, whether an absolute total return (in excess of the return hurdle) can be achieved over time. In other words, income targets should not be at the expense of long-term total return.

Secondly, whether the portfolio will sustainably produce income through a full market cycle. Usually, a company's exposure to the business cycle is intrinsically linked to their earnings, profits and dividends.

The stability of income can be evaluated by looking at the predictability of a company's cash flows over time - the relationship between cash flow, the company's capital structure and its strategy for distributing this cash will ultimately impact the dividends to investors.

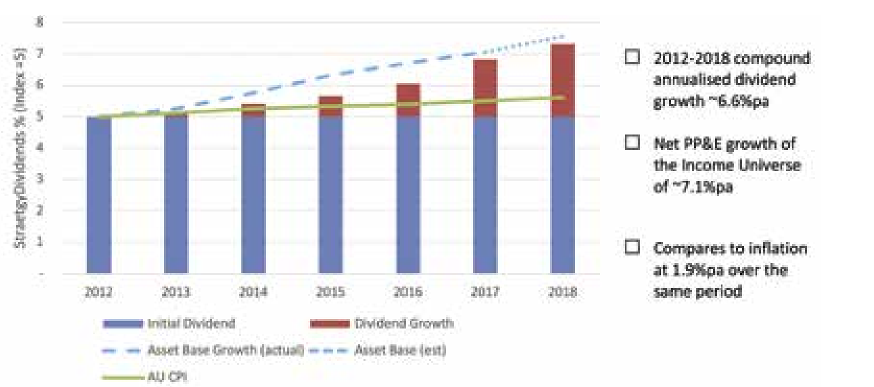
In this way, infrastructure has an edge as a long term income solution. Revenues are generally linked to the asset base of these companies, rather than to the ups and downs of economic activity. This being the case, the quality of a company's assets and a detailed assessment of the regulation or contracts governing them needs to be front and centre to a Portfolio Manager's process.This is what delivers stable cash flow and greater capital stability. As demonstrated in the chart below, a growing asset base drives growth in dividend yields. For investors, this can provide excellent visibility over revenues and dividends, particularly as we enter the later stages of the economic cycle. **FS**

Figure 1. Income Strategy Beta to Global Equities (monthly returns, local)



Source: RARE Calculations as at 31 December 2018
Global Equities – MSCI AC World, Gross, Local, FactSet Research Systems (Index Code – MSCI:892400) since 1 July 1996
RARE Infrastructure Income Strategy Rep Mandate , Local, since inception 31/10/2010.

Figure 2. The RARE Infrastructure Income Strategy Annual Dividend over time (index =5)



Should investors brace for an impending recession? Since the start of the year, many financial advisers have been rebalancing their client portfolios to reflect the possibility of a market downturn. Those who were already working in the industry during the GFC didn't want their clients to suffer the same experience as they did then – many were caught out by liquidity issues and sudden drops in their share portfolios.

In this edition, we look at the thinking behind RARE Infrastructure and how it has developed a strategy that aims to lessen the impact of economic downturns. Drawing on its monthly return figures and dividend growth pattern over the long term, Shane Hurst explains how the fund manager delivers a compelling case for investors seeking income during uncertain times. This article is a back-to-the-basics look at what drives predictable cashflow and dividends during a slowdown.

Michelle Baltazar
Director of Media & Publishing

The quote

In the late stages of an economic cycle, infrastructure can offer investors lower volatility, stable cash flow, inflation protection and diversification.

Watch the video on www.fsitv.com