Active Global Listed Infrastructure Strategies to offer better downside protection for investors

"For Professional and Sophisticated Investors Only"

Foresight Analytics™

Summary

- Global listed infrastructure investors have earned very healthy returns over the past decade.
- Despite increasing allocations in the past decade, the asset class is still under owned by many Superannuation funds.
- Strong secular returns have been underpinned by earnings and distribution growth, lower global bond yields also provided very strong valuation tailwind for the sector.
- Active manager performance has been mixed over the last decade amid rising supply of managers and product options.
- Investors should move away from passive or closet indexing strategies and focus on high active share, high tracking error strategies to experience better downside protection in a rising bond yield environment.

Exhibit 1: Performance of Global listed infrastructure and Global Real Estate Indices (AUD, 31.5.18)

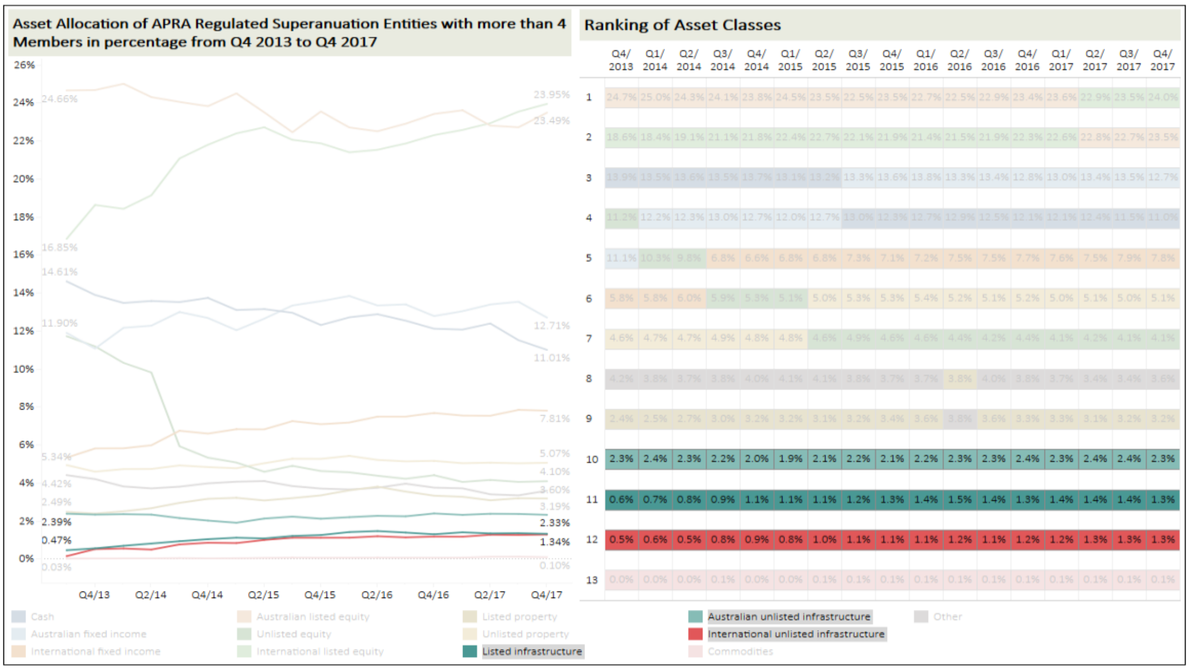
Period	11/08 to 05/18	**Index**	Multiple values

The percentage in brackets is annualised return.
Source: Foresight Digital
Data source: Australian Bureau of Statistics (ABS), Australian Prudential Regulation Authority (APRA), Rainmaker, Morningstar and eVestment

Asset class is strategically under owned

Global listed infrastructure (GLI) as an asset class is still underpenetrated from a strategic allocation perspective. While many Institutional investors have an allocation to Australian and Global listed and unlisted Infrastructure, we believe there is room for significant growth in GLI allocations going forward. Compared to other asset classes, GLI has ranked low in the allocation to ‘bond proxies’ despite the vast opportunity set. The allocation trend of Australian superannuation funds is shown in Exhibit 2.

Exhibit 2: Asset Allocation by Australian Superannuation Funds to GLI and GULI is comparatively low



Source: Foresight Digital
Data source: Australian Bureau of Statistics (ABS), Australian Prudential Regulation Authority (APRA), Rainmaker, Morningstar and eVestment

Mixed performance from active manager universe

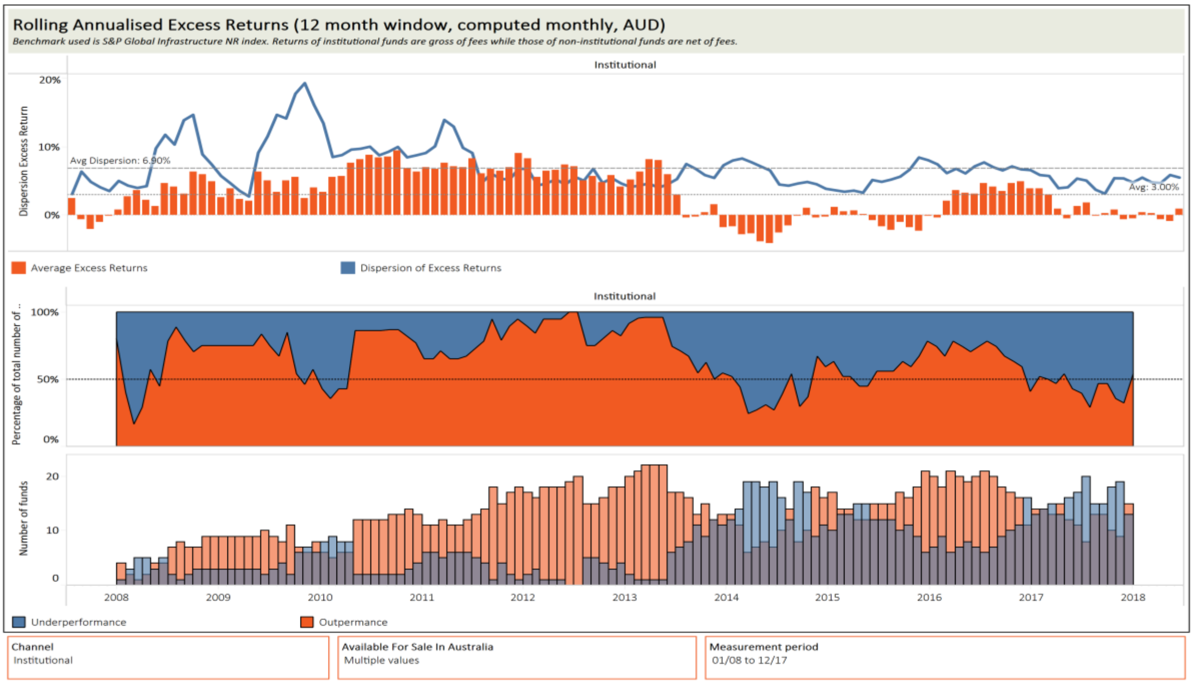
While genuine earnings and income growth has been one of the key drivers of asset class returns, falling global long term bond yields have also provided significant valuation-based tailwind. With re-setting of inflation expectation and global interest rates underway, the valuation based tailwind is likely to turn into a headwind. We believe greater selectivity and discernment from investors is required going forward to preserve capital and experience favorable risk-adjusted returns. Investors should note that not all active strategies will provide superior outcomes.

Our analysis of the GLI sector shows risk-adjusted returns from active managers generally have been mixed. While active returns between 2008 and 2013 were very healthy, performance post 2013 has been patchy and disappointing. Over the pre-2013 period, average annualised excess return was very high at 5.17% per annum whereas the number decreased significantly to merely 0.34% per annum for the post-2013 period. The percentage of active managers beating index for instance during the first phase of the cycle was 75% while this dropped to 53% over the second phase of the cycle.

Further, the number of strategies available for investors (supply indicator) has risen steadily over this period, from less than 10 in 2008 to more than 30 today. This represented over 300% rise in supply of strategies or product options.

This certainly shows that there has been greater competition for good alpha ideas however this needs to be placed within the context of expanding opportunity set (increased listing of new securities).

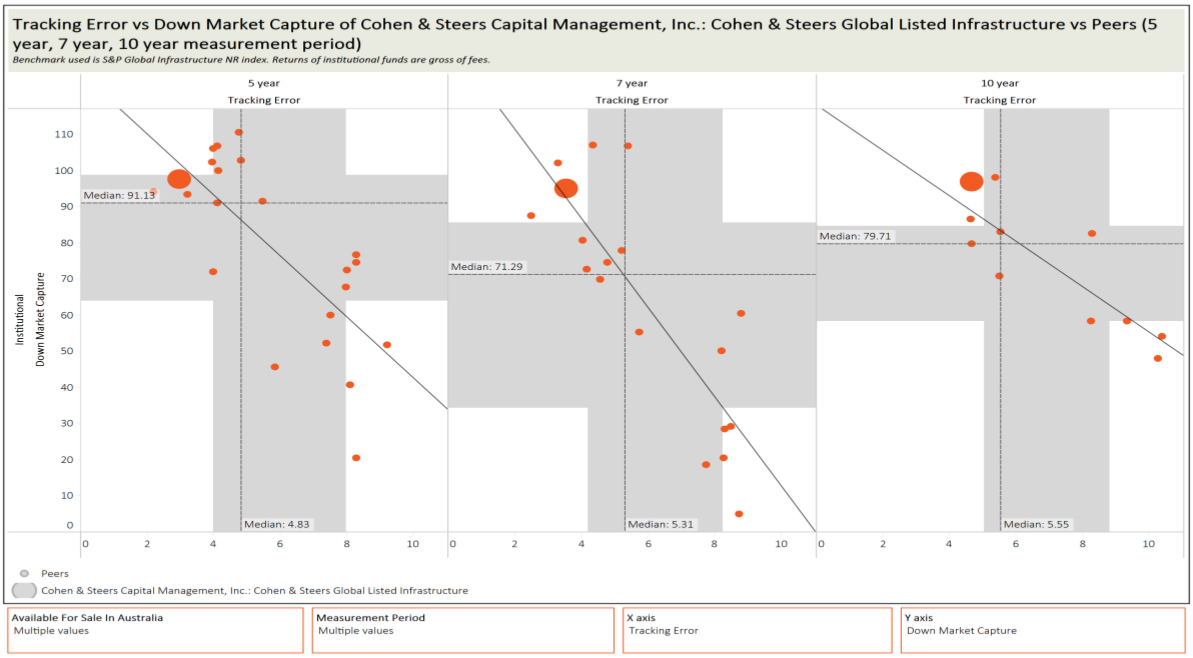
Exhibit 3. Active Managers have delivered mixed results over the past decade, supply of new funds have increased by more than 300%



Source: Foresight Digital
Data source: Australian Bureau of Statistics (ABS), Australian Prudential Regulation Authority (APRA), Rainmaker, Morningstar and eVestment

In terms of risk, there appeared to be a strong linear relationship between downside risk protection and the level of active risk taken by managers as illustrated in Exhibit 4 below. The estimated Pearson correlations between downside market capture and tracking error of managers over a 3-year, 5-year, and 7-year periods were -0.78, -0,75 and -0.83, respectively. These estimates were statistically different from zero at 5% significance level. This indicates that managers with high active risk tend to have better downside protection, an attribute that we believe will be important going forward.

Exhibit 4. Strong positive relationship between manager downside protection and active risk

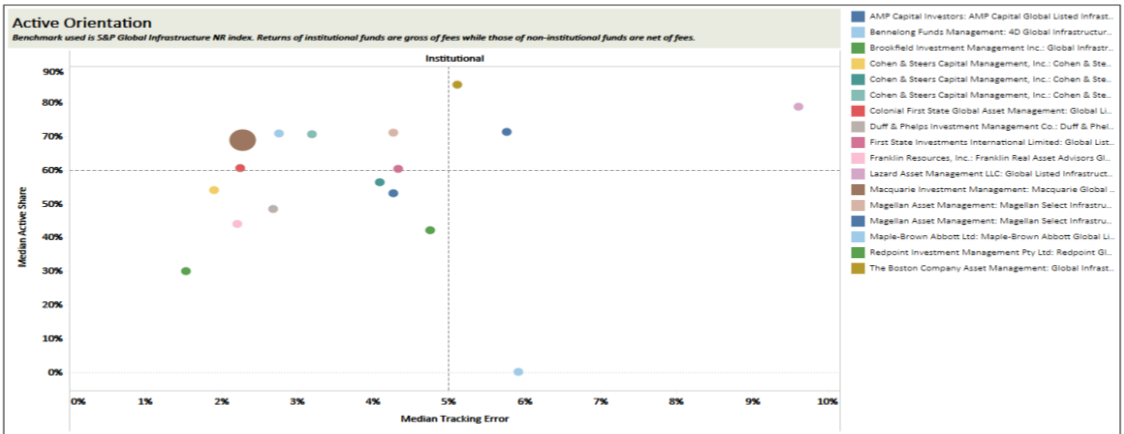


Source: Foresight Digital
Data source: Australian Bureau of Statistics (ABS), Australian Prudential Regulation Authority (APRA), Rainmaker, Morningstar and eVestment

Active Orientation of Managers is skewed towards 'Closet Indexing'

Our data on active orientation of GLI managers across ex-ante tracking error and active share reveals very interesting insights on the manager portfolios. Of the 17 strategies reviewed, 7 (41%) were classed as 'closet indexers', while 6 (35%) were classified as 'diversified stock pickers' and 3 (17%) were classified as 'concentrated stock pickers'. Investors looking to benefit from strong active management and downside capital protection to select high active share, high tracking error strategies.

Exhibit 5. Higher Active Share and Tracking Error strategies offer better downside protection for investors



Institutional				
Stock Pickers: Concentrated Factor Exposures	Stock Pickers: Diversified Factor Exposures	Closet Indexers	Factor Bets	Grand Total
3 17.65%	6 35.29%	7 41.18%	1 5.88%	17 100.00%

Assets under management (31.12.2017): $72M, $1,000M, $2,000M, $3,000M, $3,877M

Channel	Available For Sale In Australia	Measurement Period
Institutional	Multiple values	01/08 to 12/17

Source: Foresight Digital
Data source: Australian Bureau of Statistics (ABS), Australian Prudential Regulation Authority (APRA), Rainmaker, Morningstar and eVestment

Institutional and Non-Institutional Flows Have been very strong towards active strategies

Exhibit 6 and 7 below show the institutional and non-institutional flows to mainly active products over the past 10 years. The most dominant trend has been the exponential increase in assets over this period. In addition, the number of products and management specialists have increased substantially over the period. While this has lead to greater choice for investors and increasing capacity provision, it has also increased the level of competition for alpha ideas.

Notable firms that have contributed to growth from both the institutional and non-institutional sides are Lazard Asset Management LLC, Magellan Asset Management, RARE Infrastructure Ltd and First State Investments International Ltd..

Exhibit 6. Total AUM (Institutional) has been consistently increasing

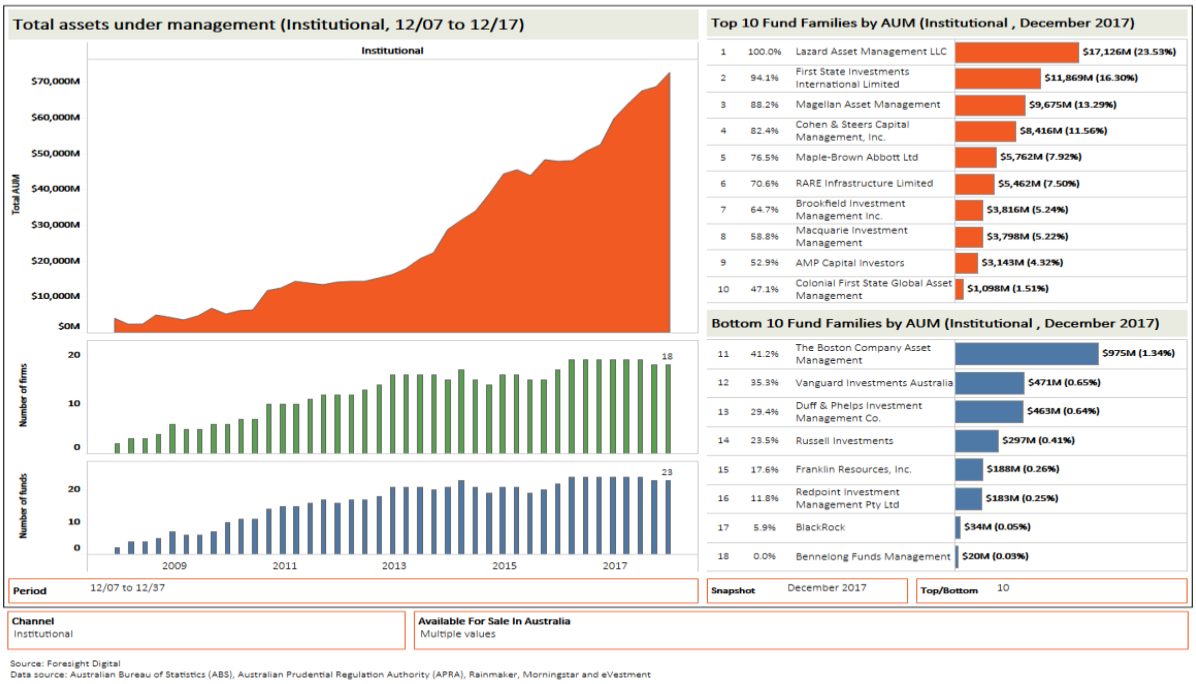
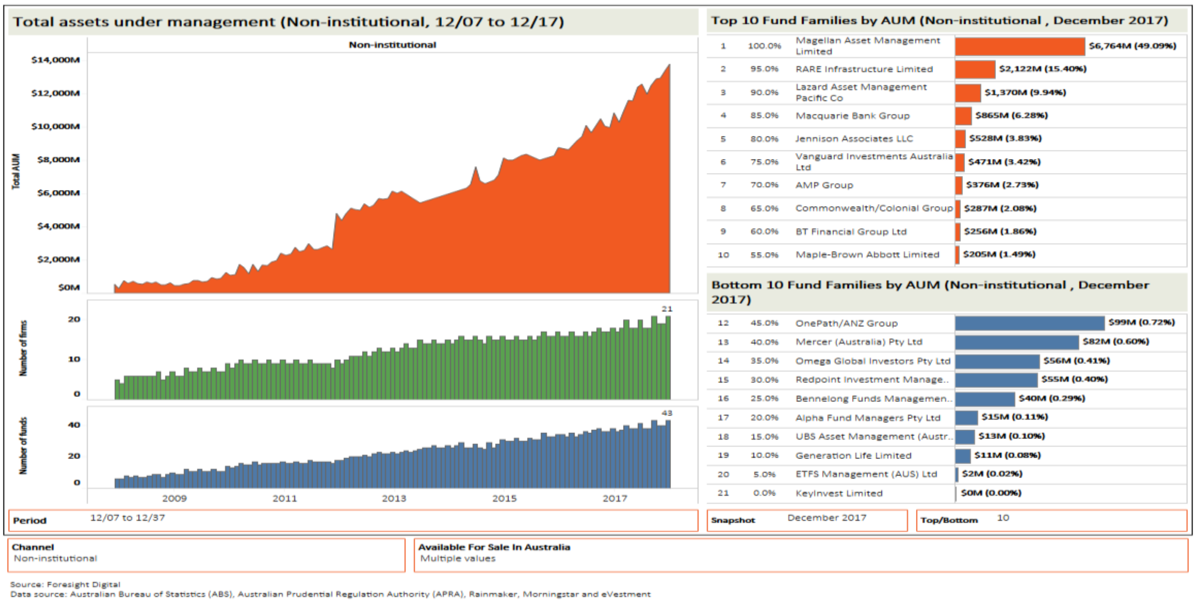


Exhibit 7. Total AUM (Non-Institutional) experienced consistent growth



What's next?

Global Listed Infrastructure investors have experienced very strong returns over the past decade, largely thanks to favorable interest rate environment for long-duration assets or bond-proxies. With re-setting of inflation expectation and global interest rates underway, the valuation based tailwind is likely to turn into a headwind for this asset class. We believe greater selectivity and discernment is required going forward to preserve capital and experience favorable risk-adjusted returns.

Investors should focus on strategies that are highly active (not passive or closet indexing), that offer idiosyncratic exposures and not just systematic exposure to yield, valuation of growth. Quality attributes such as financial leverage would become more critical in a rising cost of capital environment.

About Foresight Analytics™

Foresight Analytics™ is a leading provider of quantitative investment research, analytics and consulting solutions to global investors, fund buyers and fund sellers. Using its innovative 360-degree framework and cloud-based technology, Foresight Analytics provides insight-based analytical and industry intelligence solutions to leading investment management companies, superannuation funds, third-party product distributors, family offices and endowment funds.

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