Growth and resilience – is infrastructure the answer?

Soaring inflation, rising interest rates and widespread labour strikes. Sound familiar? The UK currently feels eerily reminiscent of the 1970s. However, pension investors today have options not available 50 years ago

Is history repeating itself? Some may recall the dire economic situation the UK was in during much of the 1970s. Although an easy comparison to make, the reality is that the UK is nowhere near this point (yet). However high inflation and rising rates are a present-day fact with investors exploring solutions able to provide a predictable income stream and a degree of protection.

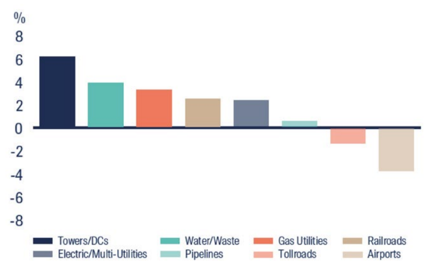
An investment safe haven

Where might they look? An area of strong investor interest recently has been real assets. For investors seeking refuge from 1970's style hyper-inflation and rapidly rising interest rates, within the world of real assets, infrastructure is worthy of consideration.

Many of the core characteristics of infrastructure provide a natural defence. Infrastructure's tangible assets, often delivering essential services such as transportation and energy, provide natural resilience to economic headwinds. The fact many infrastructure operators have regulated business models allowing real returns, ensures they are price makers rather than price takers. Inflation fuelled higher input costs are able to be passed through to the end-customer.

This relative defensiveness is clear from the chart below. Based on the worst monthly market downturns over almost 15 years, it shows how different listed infrastructure sectors outperformed global equities overall. The time interval shown does not cover the recent Covid period and the relative performance may therefore differ for this period.

Outperformance vs MSCI World during the 15 worst down months 2007 - 2020



Source: Bloomberg, First Sentier Investors

Rising concerns about rising rates?

For many infrastructure companies this is unlikely to be a major issue. Given the long-duration nature of their assets, often the debt capital employed within their businesses will be long dated. Many infrastructure companies have taken the opportunity to lock in their debt financing at very low rates and over an extended period. Rising interest rates will likely have minimal impact.

The defensive characteristics of infrastructure are further supported by high barriers to entry. Setting up a rail freight network, building out a data network or constructing a new airport terminal is highly capital intensive - an active deterrent for new entrants. The sheer capital commitment required to become a competitor allows robust pricing for incumbents also.

Resilience and growth

Infrastructure is not just a defensive choice, it leverages many long-term societal and economic themes. Parallels with the 1970s look even shakier with an appreciation of the intrinsic growth profile of the asset class.

Decarbonisation of energy generation, transport electrification and 5G data rollout – these are not transitory events but multi-decade investment opportunities dependent on infrastructure providers. For pension funds, these long-term drivers, together with the defensive market characteristics of the asset class, should make infrastructure a key consideration and a highly attractive area of investment.

History is not repeating itself

Anticipating rampant inflation, rising rates and economic recession is understandable, but history is not always an accurate predictor of the future. For those prepared to consider investing in infrastructure assets the future is bright, with the 1970s safely relegated to the dim and distant past!

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