Cohen & Steers Global Listed Infrastructure Strategy

The global infrastructure securities market, as represented by the FTSE Global Core Infrastructure 50/50 Net Tax Index, had a total return of 6.6% in the second quarter in Australian dollars, bringing the year-to-date return to 3.8%.

Investment Review

The second quarter was positive for global infrastructure stocks, which outperformed global equities. Markets were choppy as trade tensions escalated between the U.S. and China, while economic growth remained relatively strong globally, although Europe showed some signs of deceleration. The yield on the benchmark 10-year U.S. Treasury note reached a high of 3.1% mid-quarter as markets anticipated additional Federal Reserve tightening due to a strong economy and falling unemployment, which reached its lowest level in two decades. However, the 10-year yield finished relatively unchanged, falling back as rising protectionism raised concerns over growth.

Sector Highlights

- Midstream energy (14.5% total return in the index[1]) equities had a strong recovery in the second quarter, as earnings generally beat expectations and fundamentals continued to improve sector wide due to high, stable energy prices and rising production volumes. The Organization of Petroleum Exporting Countries (OPEC) and Russia also announced an oil production increase that we believe will bring an additional 600,000 to 700,000 barrels per day to global markets, which was less than some market participants feared.
- Tower companies (–0.5%) underperformed after T-Mobile and Sprint announced their third attempt to merge. Consolidation of wireless carriers in the U.S. could reduce tenant demand for towers in the medium-to-long term. However, we believe tower companies will stand to benefit from strong secular demand growth for wireless data services and the adoption of 5G, small cells and other technologies to handle the increasing data usage.
- Marine ports (–3.9%) lagged, as the sector tends to be more closely associated with trade, during a period in which trade concerns increased.
- Railways (9.3%), particularly those in North America, benefited from stronger-than-expected volume growth across all segments, as well as recommitments to their restructuring and capital allocation plans.
- Toll roads (1.7%) underperformed amid political concerns in Italy, as well as Brazil, where less favorable outcomes for toll road operators seeking to renegotiate and extend their concessions continued to surface.
- Airports (1.7%) underperformed due to weakness in Italy and also in Mexico. Investors soured on Mexico's prospects amid concerns regarding upcoming elections, renegotiating trade agreements with the U.S. and currency risk.

Index Performance by Sector

Sector	Q2 2018	YTD 2018
Gas Distribution	8.72 %	11.52 %
Railways	9.33 %	6.33 %
Communications	2.83 %	1.93 %
Midstream	14.54 %	0.60 %
Electric	3.48 %	-0.26 %
Airports	1.72 %	-2.25 %
Toll Roads	1.72 %	-5.22 %
Water	2.36 %	-5.93 %
Diversified	4.09 %	-9.61 %
Marine Ports	-3.92 %	-13.67 %

Source: Cohen & Steers.

Data quoted represents past performance, which is no guarantee of future results. This information is not representative of any Cohen & Steers account and no such account will seek to replicate an index. You cannot invest directly in an index and index performance does not reflect the deduction of any fees, expenses or taxes.

Portfolio Performance

The portfolio had a positive total return in the quarter, but underperformed its benchmark. Stock selection in railways detracted from relative performance, due primarily to holding an overweight in Brazil-based Rumo, which declined alongside Brazilian equities. Stock selection in the electric sector (3.5%) further detracted from performance, due in part to owning Italy-based Terna and Australia-based Spark Infrastructure Group, the latter which declined amid concerns that regulatory changes may threaten its tax-efficient structure. Stock selection in communications and airports further detracted from performance.

The portfolio's overweight in midstream and underweight in marine ports contributed favorably to relative performance. Stock selection in the diversified sector (4.1% total return in the index) also contributed to performance, due in part to holding an out-of-index position in Azure Power Global Limited, which outperformed.

Investment Outlook

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We believe the landscape remains generally favorable for infrastructure securities and the global economy as a whole. Tight labor markets and early signs of wage growth could cause the market to adjust its inflation expectations higher through the year, potentially leading to a faster pace of rate hikes and further market volatility in 2018. Historically, infrastructure has tended to outperform both stocks and bonds during periods of unexpected inflation. However, we note the increasing uncertainty around trade and tariff policies, which has the potential to negatively impact capital expenditures and confidence. In our view, the longer the uncertainty persists around trade, the greater the concern around the sustainability of our economic outlook.

While the cash-flow multiple for the listed infrastructure universe remains above the long-term average, we believe this is justified given a continuation of generally accommodative monetary policy (despite a shift to incremental tightening stances in key developed markets), strong economic conditions and upward pressure on valuations as private capital is deployed. Facing a competitive environment for the relatively few assets available for sale, private transactions have generally occurred at significant premiums to the market-implied cash flow multiples of listed infrastructure companies.

U.S. water utilities offer the potential for accelerating growth. We believe critical pipeline replacement projects across the U.S. should drive significant growth for water utilities, with the consolidation of the largely municipally owned sector a further tailwind. In our view, U.K. water utilities have underperformed due to investors pricing in the risk inherent in the upcoming regulatory rate review process.

We see secular tailwinds for towers. U.S. and European tower owners, in our view, are well-positioned to benefit from strong long-term secular demand growth for wireless data services and the adoption of 5G, small cells and other technologies to handle the increasing data usage. The sector's valuations remain attractive relative to our growth expectations.

Railways outlook strong, but sensitive to economic conditions. The outlook for freight railways in 2018 and beyond continues to be attractive, as stronger than anticipated year-over-year freight volumes are driving upward revenue guidance. This, combined with the companies' significant improvements in operational efficiency—and declining capital investments—could significantly increase free cash flow generation over the next several years.

Midstream energy sector in transition. The growth in North American energy production volumes is driving a positive shift in the fundamental cycle for midstream energy companies, translating into continued cash flow growth. While competitive conditions remain challenging, more companies are taking steps to reduce downside risk by strengthening balance sheets, increasing distribution coverage ratios, and being less reliant on capital markets to fund their growth. Our favorable view on the sector in based on these themes combined with generally attractive valuations.

Electric utilities at risk from rising rates. We generally maintain a cautious stance toward electric utilities, due to their modest growth prospects, company-specific regulatory issues and vulnerability to rising interest rates.

(1) All sector returns in this commentary are in local currencies. Sector classification of securities in the index is determined by the investment advisor.

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The S&P 1500 Utilities Index is an unmanaged market-capitalization-weighted index of companies for which the primary business involves the generation, transmission and/or distribution of electricity and/or natural gas.

The Macquarie Global Infrastructure Index, calculated and managed by FTSE, is designed to reflect the stock performance of infrastructure companies, principally those engaged in the management, ownership and/or operation of infrastructure and utility assets.

The UBS Global 50/50 Infrastructure & Utilities Index - Net tracks a 50% exposure to the global developed market utilities sector and a 50% exposure to global developed market infrastructure sector. The index is free-float market-capitalization weighted and reconstituted annually with quarterly rebalances and is net of dividend witholding taxes.

The FTSE Global Core Infrastructure 50/50 Net Tax Index is a market-capitalization-weighted index of worldwide infrastructure and infrastructure-related securities and is net of dividend withholding taxes. Constituent weights are adjusted semi-annually according to three broad industry sectors: 50% utilities, 30% transportation, and a 20% mix of other sectors, including pipelines, satellites, and telecommunication towers.

The views and opinions in the preceding commentary are as of the date of publication and are subject to change. There is no guarantee that any market forecast in this report will be realized.

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