

Income Strategy

QUARTERLY COMMENTARY | SEPTEMBER 2023



Our global listed infrastructure strategies underperformed infrastructure benchmarks and global equities for the quarter.

Slowing inflation and reasonably strong economic data have led investors to reassess their expectations of a recession in 2023, while China is experiencing economic challenges as progress in its reopening is disrupted by difficulties in the Chinese property sector.

Inflation continues to moderate, although concern remains around the level of wage inflation, making it difficult for central banks to loosen policy quickly. As expectations for a higher-for-longer interest rate backdrop gain traction, financial conditions continue to tighten, placing further stress on economic growth. Consensus continues to moderate its expectations for a recession, with the possibility of a deeper recession remaining the largest risk to investors.

Portfolio Performance

On a stock-specific basis, U.S. electric utility Constellation Energy (+0.26%) was the top contributor to quarterly performance.

Constellation Energy (**Constellation**) is primarily a nuclear generation company and is the largest producer of carbon-free electricity in the U.S., serving states including New York, Illinois, Maryland, Pennsylvania and New Jersey. The company's combined generation capacity is more than 32 GW and 90% of annual output is carbon free. Summer volatility in energy prices in Texas bodes well for Constellation's nuclear assets, which provide baseload generation.

Turning to the Asia Pacific, Japanese rail operator West Japan Railway (+0.15%) also contributed to quarterly performance.

West Japan Railway (**JR West**) is one of Japan's largest passenger railway operators. JR West operates the Shinkansen high-speed rail lines near Kansai, as well as commuter trains within the Osaka metropolitan network. JR West's share price rose with the continued recovery of domestic traffic.

U.S. electric utility NextEra Energy (-0.84 %) and U.S. renewables utility NextEra Energy Partners (-1.21%) were the largest detractors from quarterly performance.

NextEra Energy (**NextEra**) is an integrated utility business with a regulated utility operating in Florida and is the largest wind business in the U.S. NextEra's regulated business, including Florida Power & Light, serves nine million people in the State of Florida.

NextEra Energy Partners (**NEP**) is a growth-oriented contracted renewables company formed by its sponsor and general partner NextEra to own, operate and acquire contracted renewable energy generation assets located in North America.

During the quarter, NEP changed their growth guidance from 12%–15% to 5%–8% p.a. through to 2026. Additionally, they announced a reduction to their 2023 cash flow expectations. In turn, this impacted NextEra's share price as the reduction is a function of long-term interest rates, which investors now fear may be a problem for U.S. utilities more broadly.

All returns are in local currency.

Positioning and Outlook

On a regional level, the strategy's largest exposure is in the U.S. and Canada (38%), consisting of exposure to regulated and contracted utilities (27%) and economically sensitive user pays infrastructure (11%).

For the **Global Infrastructure Income Strategy**, the primary quantitative tool in portfolio construction is excess return, on which our stock-ranking system is based. The Global Infrastructure Income Strategy also uses yield quality as a secondary measure. As such, driven by valuation, the Investment Committee initiated a position in U.K. water company Severn Trent.

The Strategy also used the opportunity to crystallise some gains by exiting U.S. energy infrastructure company Williams Companies.

Quarterly Stock Highlight

This quarter we review U.K. water company Severn Trent (**SVT**).

SVT is a regulated U.K. water utility that provides water and wastewater services to the Midlands and Wales, serving over 4.5 million households and businesses.

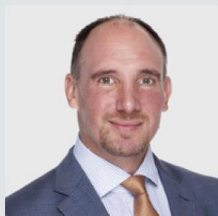
Approximately 95% of its value is regulated. U.K. water regulator Ofwat regulates these services. Ofwat reviews price limits every five years, with the current regulatory period running between April 2020 and March 2025.

We view SVT as a low-risk regulated water utility in the U.K. with inflation-linked returns. Ofwat has a long history of offering a stable regulatory framework, including inflation protection and predictable cash flows. Ofwat confirmed in December 2019 the lowering of allowed real returns for the new regulatory period (PR19 for AMP7). This was mainly to reflect lower bond yields and has provided cash flow visibility for SVT over the 2020-2025 period. SVT's business plan was rewarded with fast-track status by Ofwat, giving it a strong head start on execution. It has been achieving returns above industry average in AMP6 and AMP7 to date.

SVT has maintained a constructive relationship with Ofwat. It has been the sector leader in achieving ODI rewards, which drives superior operational outperformance. In 2022, it was also approved £565 million of green recovery investment, being the company approved for the largest green recovery investment within the U.K. water industry. Driven by high inflation headlines and green recovery investment, SVT targets resilient AMP7 cumulative nominal regulatory capital value (**RCV**) growth of c.36% and real growth of c.11%.

The PR24 process has started, with the final methodology being constructive, and Ofwat has signalled increasing needs to investment underpinned by climate change and net-zero targets. There is also potential valuation upside from M&A, given the premium multiples being paid for U.K. regulated asset acquisitions. For AMP7, the dividend policy is set at the growth rate of CPIH, or U.K. inflation including housing costs.

Nick Langley, Shane Hurst, Charles Hamieh and Daniel Chu Investment Committee Members



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