Stirling Infrastructure
PARTNERS LTD

Why Invest in Infrastructure?

REPORT

Infrastructure Analysis

INTRODUCTION

With the Covid-19 pandemic heightening the volatility of global investments in 2020, the infrastructure asset class has held up remarkably well, even seeing an overall improvement in the aggregate capital raised by unlisted infrastructure funds since 2018 . Investors' attention has been drawn to this asset class which is expected to grow significantly given these trends and there are many compelling reasons for this.

CORRELATIONS

One of the great strengths of the infrastructure asset class is that empirical evidence suggests that its returns have a low correlation with other classes , . This makes infrastructure a very appealing investment to those who wish to diversify their portfolios and make steady returns while doing so.

Figure 1.1 - Correlation of Returns Between Asset Classes (2021)

	2008 - 2020	Global Bonds	Global Equities	U.S. Core	Europe Core RE (Continental Europe)	APAC Core RE	Global Core Infra	Direct Lending	Venture Capital	Private Equity	Equity Long/Short	Relative Value	Macro	Bitcoin
Financial assets	Global Bonds	1.0												
	Global Equities	0.3	1.0											
Global real estate	U.S. Core	-0.2	0.0	1.0										
	Europe Core RE (Continental Europe)	-0.3	0.2	0.8	1.0									
	APAC Core RE	-0.2	0.0	0.8	0.8	1.0								
Infra	Global Core Infra	-0.1	-0.1	0.3	0.1	0.2	1.0							
Private markets	Direct Lending	-0.1	0.7	0.3	0.4	0.3	0.1	1.0						
	Venture Capital	0.0	0.5	0.3	0.5	0.3	0.1	0.5	1.0					
	Private Equity	0.0	0.8	0.3	0.5	0.3	0.1	0.9	0.8	1.0				
Hedge funds	Equity Long/Short	0.2	1.0	0.0	0.2	0.0	-0.1	0.7	0.6	0.9	1.0			
	Relative Value	0.1	0.9	-0.1	0.1	0.0	-0.1	0.9	0.5	0.8	0.9	1.0		
	Macro	0.4	0.4	-0.2	-0.1	-0.2	-0.1	0.1	0.2	0.2	0.4	0.3	1.0	
Crypto	Bitcoin	0.1	0.1	0.3	-0.1	0.1	0.5	0.1	0.2	0.2	0.1	0.1	0.0	1.0

Source: MSCI, Bloomberg, Barclays, NCREIF, JP Morgan Asset Management

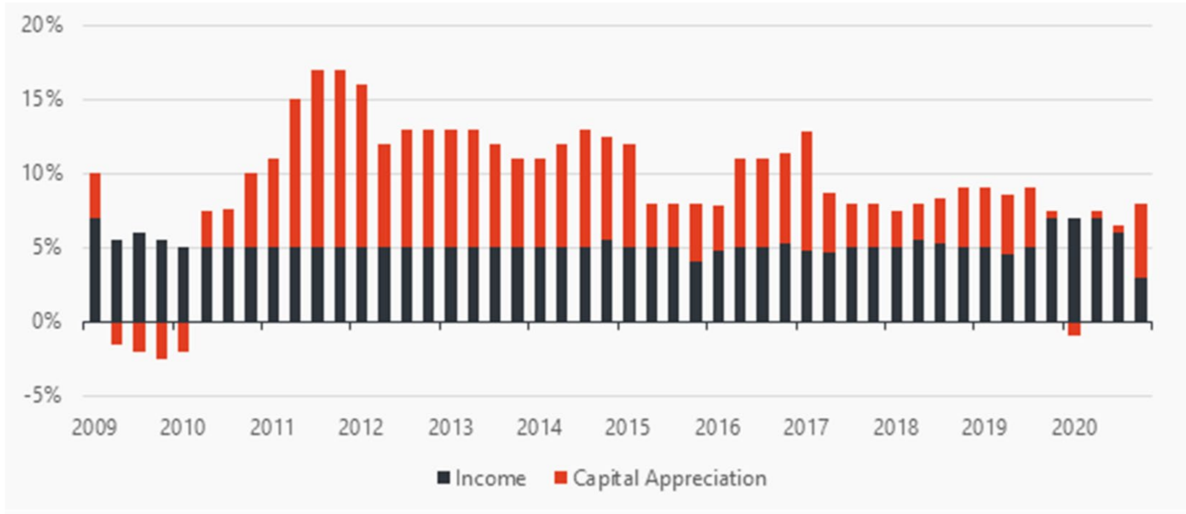
INFRASTRUCTURE RETURNS STRATEGY

Many infrastructure projects target returns predominantly in the form of regular incomes rather than through capital gains. This makes the infrastructure asset class stand out as many of these incomes – especially those in the more thoroughly regulated sectors such as energy and water - are generally inelastic, therefore ensuring reliable returns for investors. This mechanism also contributes to the low levels of correlation with other asset classes, as many returns from infrastructure projects are not dependent on the same factors which cause the returns from other classes to fluctuate. The stability of these incomes also means that larger amounts of debt can be leveraged against infrastructure assets giving them more capital to use in their development.

VOLATILITY

These factors – each contributing to the low-volatility returns seen within the asset class – have meant that infrastructure assets have helped to stabilise overall portfolio performances while delivering higher returns than other classes. Over the last four years, they delivered a 9.3% average return against 7.7% for listed equities . Comparing performance over the last ten years, infrastructure returns experienced a lower standard deviation and higher average returns compared with both private debt and natural resources showing its value once again . The abundance of consistent, inelastic returns and low correlations with other investments makes infrastructure a particularly attractive asset class.

Figure 1.2 – Global Core Infrastructure Returns (2009-2021)



Source: MSCI, J.P. Morgan Asset Management

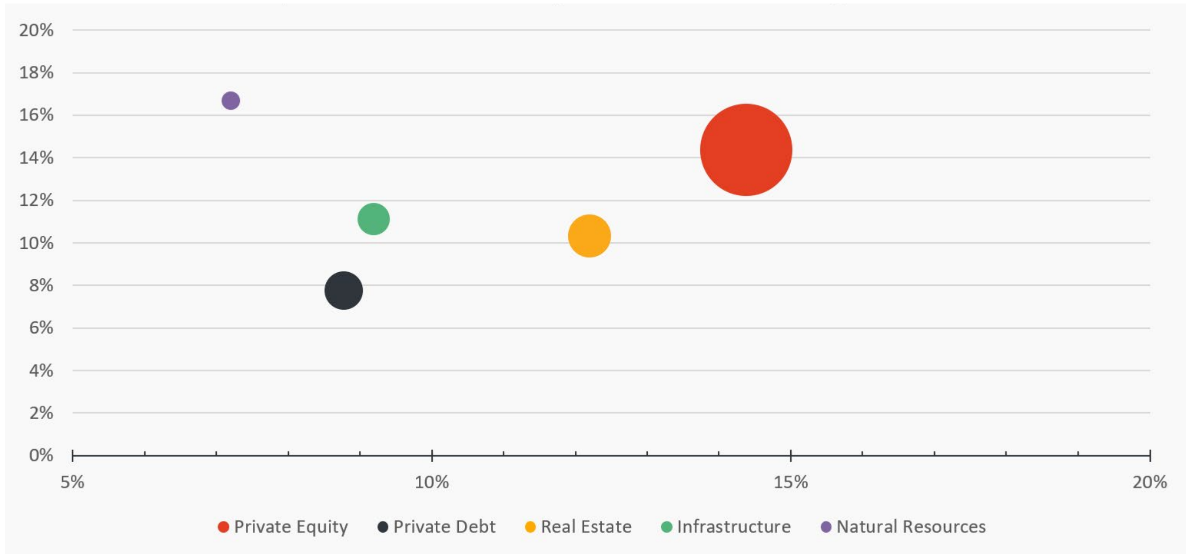
INFLATION HEDGING

Furthermore, often representing essential services, many infrastructure investments often contain a natural hedge against inflation as any wholesale price increases can be passed straight on to customers. This is especially true for heavily regulated utilities. Such investments typically also benefit from barriers to entry and often operate on long-term contracts further contributing to greater levels of stability of returns.

RELATIVE RISK

With unlisted infrastructure funds having made a combined annualised return of 7.5% in the three years up to June 2020 , this demonstrates the degree of robust returns that infrastructure investments are able to make over the medium term. This point is illustrated by Fig 1.3 which measures the median net IRR and the standard deviation net IRR across several asset classes. The internal rate of return (IRR) is the return based on investment. Standard devation is an apropriate measure for risk as it indicates the distribution of the data. Therefore, the asset classes with a larger standard deviation involve greater levels of risk.

Figure 1.3 – Risk/Return by Asset Class for Private Capital (2008-20017)



Source: Preqin Pro

**The size of each circle represents the capitalisation of funds used in this analysis.*

The benefits of infrastructure in the unlisted market can be seen in Fig.1.3. With regard to returns, infrastructure outperforms listed real estate and natural resources. All the while infrastructure investments incur less risk than private equity and natural resource investments. This suggests that the infrastructure asset class is a viable and reliable alternative to some of the more traditional investments.

GOVERNMENT INVESTMENT AND SUPPORT

A further consideration in favour of investment in infrastructure is that governments have been keen to target infrastructure investment in 2021 as a way of growing their economies following the COVID-19 pandemic. The UK government has published its "Build Back Better" plan which poses a number of important national infrastructure projects and outlines the government's commitment to investing "record amounts" in infrastructure . It has since established the UK Infrastructure Bank which is providing £22bn in infrastructure finance showing its commitment to the development of this asset class . Similarly, the United States has unveiled plans to invest in infrastructure over the coming years with a $1.2tn support package. Similar trends have been observed on a global level. The Asian Development Bank has committed to scaling up its operations investing $14Bn in infrastructure while the World Bank has sought to commit to infrastructure projects in many developing countries . Given the commitment that governments have made and are planning to make in the coming years, these are encouraging signs indicating a strong resurgence in investment in infrastructure assets.

CONCLUSION

In comparison to other asset classes, infrastructure investments provide lower risk than stock markets and other alternatives and higher yields than bonds. Bearing in mind the global needs for infrastructure investments as well as the available institutional capital, it is clear that the infrastructure market is nowhere near saturation. Stirling Infrastructure provides institutional investors with independent analysis and advice using our proprietary processes and its specialist sector knowledge developed over decades to evaluate infrastructure investments. We carry out due diligence and benchmark direct transactions and funds against a range of KPIs. From this data, our analysts are able to determine whether an investment is, on an objective basis, likely to offer an appropriate risk and return for a specific investor.

FOR FURTHER INFORMATION

This paper provides insights into trend data with analysis for institutional investors to make an informed investment decision into the infrastructure asset class.

The firm provides a comprehensive range of services which includes M&A transaction services, raising both debt and equity to finance infrastructure projects globally and the objective selection of asset managers for capital allocation.

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