Q3 2024 Review

Partners Group Listed Investments SICAV – Listed Infrastructure

PARTNERS GROUP

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2024 Q3 review

Key market drivers
Global equity markets experienced significant volatility in Q3, particularly during the first weeks of August, before recovering for the remainder of the quarter. The quarter began with US inflation coming in below expectations, an increase in the US jobless rate, and technology companies reporting weaker Q2 earnings, contributing to a slight unwinding of the 'AI trade.' While inflation has remained stubbornly above 2%, the Federal Reserve implemented a 50 basis point rate cut, which exceeded expectations and made a soft-landing scenario more likely. In this overall volatile equity market environment, the Partners Group Listed Investments SICAV - Listed Infrastructure Fund achieved a positive 8.5% return during the quarter, significantly outperforming broader equity markets by over 700 basis points and highlighting the fund's diversification benefits. This strong performance was supported by robust Q2 results from our portfolio companies, as well as lower yields during the quarter.

Communication infrastructure was one of the main drivers of performance during the quarter, with both towers and data centers performing very strongly following good Q2 results. Regulated utilities and water also performed well, although waste management companies experienced a slight decline after a solid return leading up to Q3. Transport was another stable performer, following strong performance for the year prior to Q3, with gains driven by toll roads and airports but moderated by railways. The fund's performance matched that of its benchmark, although the main drivers of the latter were generation utilities and energy pipelines, where the benchmark has a significant overweight compared to our fund.

Key portfolio drivers
Transport infrastructure was one of the stable performers within the fund, rising by approximately 4% during the quarter. This performance was driven largely by toll roads and airports, while railroads and logistics were slight detractors. Aena, the Spanish airport operator, continued its strong performance during the quarter, reporting sustained positive traffic trends, with quarterly traffic rising by high single digits compared to 2019 levels. Conversely, ArcBest, the North American LTL freight operator, was one of the poorer performers, reporting slightly weaker-than-expected results. A soft freight environment led to lower shipments and weaker rates, resulting in Q2 revenues falling by 2% year-on-year. Despite weak revenues, operating income grew in Q2 as the company continued to implement operational efficiency initiatives.

Communication infrastructure was the best performer during the quarter, erasing all losses for the year and now generating positive year-to-date performance. The sector's performance was led by AMT, which reported solid Q2 results ahead of expectations and robust domestic leasing trends in the US. The company also raised its guidance for FY 2024, driven by lower losses in its India segment, despite absorbing more foreign exchange losses from its international operations. The other two US tower operators - CCI and SBAC - also reported in-line results but benefited to some extent from AMT's strong results, as well as a decrease in US long-term sovereign bond yields during the month. Cellnex, the largest European tower company, also reported solid Q2 results and made good progress on its asset sale program. In August, the company announced the sale of its Austrian business, which was considered non-core, allowing it to further reduce debt. As the balance sheet improves, we expect Cellnex to announce a buyback program sooner than anticipated, as its valuation remains discounted compared to peers and private transactions.

Utilities broadly contributed well to Q3 performance, driven by regulated utilities, water, and renewables, although waste operators acted as minor detractors during the quarter. Orsted, the Danish offshore wind operator, performed well, benefiting from the dovish tone of the Fed and making progress on its investment portfolio by securing 3.5 GW of UK offshore wind projects at a 45% power price increase compared to 2022 levels. The combination of higher tariffs and falling interest rates should support the investment thesis. All US and European regulated utilities also performed strongly during the quarter, rising by more than 15% as they reported positive Q2 results and benefited from softening yields in both regions. Williams, the US gas pipeline operator, was another standout performer after reporting better-than-expected results, as gas demand continues to benefit from the explosive growth of data centers.

Finally, both social infrastructure operators in our portfolio increased in value during the quarter, with HICL being the stronger performer, as yields on long-dated UK bonds softened.

Portfolio positioning and outlook

During the quarter, we made a few changes, increasing our allocation to US transport infrastructure as valuations appeared compelling, while we reduced our allocation to Australia due to a lack of imminent catalysts. Furthermore, we increased our allocation to US energy pipelines, especially those focused on natural gas, as we believe the data center theme will continue to evolve over the coming years and gas demand should persistently grow. We divested four positions during the quarter, either due to strong previous performance (Sabesp, Fortis) or a lack of foreseeable catalysts (Aurizon).

Among sectors, communication infrastructure remains one of our key focus areas over the next few years, given the strong tailwinds for the sector. We continue to see substantial investment needs that could drive earnings growth over the medium to long term. We observe more potential for outsourcing tower operations by mobile network operators (MNOs) in Europe, and 5G investments by US-based MNOs are expected to accelerate further. These companies are projected to grow in the mid-to-high single digits (higher in some cases), supported by very long-term contracts (~30 years in some cases) and very healthy EBITDA margins (>50%). They also incorporate inflation escalators, with very low maintenance capex as a percentage of revenue. We do not believe that sub-20x P/AFFO multiples will persist for long, and we expect the market to respond positively to earnings growth within the sector. Data centers are also expected to benefit from these long-term secular trends. We have increased our position in communication infrastructure over the past two years, as we find the underlying fundamentals and leasing activity remain robust.

We continue to identify good opportunities within regulated utilities. Most companies in the sector have reported strong FY 2023 earnings, and we expect this trend to continue. During the pandemic, regulated utilities did not modify their medium-term investment plans nor face unfavorable regulatory changes, both of which are positive indicators for potential earnings growth in the sector. Within the sector, we continue to emphasize electric and water utilities and have adjusted allocations accordingly. Furthermore, those utilities capable of stable regulation, with a strong balance sheet and meaningful capex on their regulated asset base, should outperform even in a rising interest rate environment.

We remain positive on US waste managers, and our exposure to the sector has grown accordingly over the past two years. Finally, while the performance of transport infrastructure has recovered to some extent, we find that toll road traffic has rebounded more meaningfully, while airport passenger numbers are still slightly below pre-COVID levels. This is evident from Vinci's reported numbers, showing that toll road traffic in 2022 was already above 2019 levels, while airport passenger numbers are expected to exceed pre-pandemic levels in the 2024-2025 period. We continue to take a cautious approach in this sector and believe that traffic on toll roads will recover faster than airports, given sustained appetite for travel. Furthermore, toll road valuations appear attractive. We are cautious about airports over the medium term, especially those exposed to international long-haul, business, and transfer traffic. We also maintain a positive outlook for railroads.

In summary, our portfolio is well-balanced between defensiveness and growth, as well as well-diversified across infrastructure sectors. Two-thirds of the portfolio remains invested in less GDP-sensitive sectors, such as regulated utilities, towers, and social infrastructure operators, which are likely to continue providing growth even in an economic downturn scenario. The underlying portfolio companies continue to perform well from a fundamental perspective. Furthermore, a scenario of rising nominal rates is not necessarily negative for Partners Group Listed Infrastructure, as more than 70% of the underlying revenues of portfolio companies are directly or indirectly linked to inflation.

ESG

We believe it is worthwhile to highlight that the Fund follows an ESG approach, like all Partners Group products. Partners Group has been an early mover in ESG, being a UNPRI signatory since 2001 and hosting a dedicated ESG team for many years. In the past, we have declined certain investments purely on ESG grounds, and the exclusion of power generation—particularly "dirty" coal-fired power plants and "tail-risk" nuclear power plants—enhances the fund's ESG relevance. We would also like to highlight that our fund is rated 'AA' by the MSCI ESG platform.

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