Market and Fund Performance commentary

Equity markets were volatile and somewhat weak during the first quarter of 2025, with global equities (in AUD terms) down 2.4%. The listed infrastructure sector performed well in the uncertain conditions, with the FTSE Global Core Infrastructure 50/50 Index (AUD) up 4.1%. The Fund, being up 8.5%, had a very strong quarter relative to the infrastructure sector.

During the quarter US regulated utilities were strong, continuing to benefit from the surge in power demand that is being seen in the US and our stock selection contributed positive attribution. Telecommunication tower companies also saw some stronger performance, from what we had viewed as a heavily over-sold level, and so our over-weight position significantly contributed to performance. The Fund benefitted during the quarter from largely avoiding detractors, at a sector and country level. In particular, our investment strategy avoids many trade related and overly sensitive economic sectors such as ports and North American railways.

We believe the Fund continues to be invested in core infrastructure assets that have high barriers to entry and strong strategic positions. We expect that long-dated, stable income streams, like those from infrastructure assets, will be keenly sought by investors and that the sector will benefit from a growing need for additional infrastructure investment. We continue to view the sector valuation as being attractive, with ongoing divergence in individual stock valuations providing opportunities.

Portfolio discussion

As at 31 March 2025, the Fund held 30 high quality infrastructure securities across 12 countries.

The largest individual country exposure remains the United States of America at 39%, which decreased over the quarter. The UK (17%) was our next largest, followed by France (9%), which both increased.

From a sector perspective, our largest holdings continue to be in regulated assets (50%), which was unchanged over the quarter. Our holdings of contracted assets (27%) were little changed and holdings of transportation concessions (20%), such as airport and toll-road assets, decreased.

The investment team is continually looking on a bottom-up basis for attractive investment opportunities to add to the portfolio. We expect this will result in a fairly low level of portfolio turnover as individual stocks fluctuate between being oversold or overbought.

Selected infrastructure news items

— In January, several large wildfires broke out in Los Angeles, California. The Eaton fire has been of particular focus for infrastructure investors as the ignition point occurred within Southern California Edison's (SCE) service territory, which is owned by Edison International (not held). The fire burned over 14,000 acres across Altadena and Pasadena, destroying 9,414 structures and resulting in 17 fatalities. The investigation into the cause of the fire remains ongoing, but the consensus has focused on a likely cause being due to induction energising an idle transmission line owned by SCE. Despite the existence of California's $21 billion wildfire fund, which was designed to provide a financial backstop to utility-caused wildfires, markets questioned whether it will continue to be sufficiently capitalised to protect utilities from future wildfire liabilities, as there are currently no established mechanisms to replenish the Fund. These concerns are also relevant for peer Californian utility PG&E (not held), which has a history of involvement in multiple utility-caused wildfires.

— Fund holding Entergy's earnings updates saw another meaningfully positive update to its business plan driven by the continued large load growth opportunities in the US. The company increased its capital plan by 8% ($2.7b), which comes on top of a 21% ($7b) increase only a quarter ago. The latest upward revision to capex relates to increased generation spend in Mississippi and Louisiana, some of which will support additional load growth from another new, unnamed large load customer in Mississippi (following Meta and AWS announcements in 2024). Further supporting the growth outlook, Hyundai announced during the quarter a $5.8 billion investment to build a steel factory in Louisianna served by Entergy. As a sign of management's confidence in the plan, the company formally removed the top-end of their prior 8-9% EPS growth range.

— In March, fund holding Crown Castle Inc. (CCI) announced that it had signed a definitive agreement to sell its fiber and small cells segment for US$8.5 billion to EQT and Zayo Group. This announcement concludes the extensive fiber segment strategic review by the company and was a positive clearing event for the stock, with the outcome itself being broadly in line with market expectations. After the sale closes (expected in the first half of 2026), CCI will complete a US$3 billion buyback and will become the only listed pure-play, standalone US cell tower company.

ESG integration

The end of the road(?)

Since President Trump's inauguration in January 2025, there have been swift and sweeping attempts to roll back many ESG and climate-related initiatives built upon by the previous Biden administration. Examples include dismantling Diversity, Equity, and Inclusion (DEI) initiatives across US federal government and agencies, rolling back key pollution and emissions regulations by the Environmental Protection Agency (EPA) and threatening to rescind aspects of the Inflation Reduction Act (IRA).

In response, the US financial sector has notably reversed previous net zero commitments, with many large financial corporates publicly exiting industry initiatives. Some have remained silent or removed any mention of ESG or climate change in their reporting and public messaging. One would assume we are at the end of the road for ESG and sustainability focused investing.

Tough terrain for renewables

The negative sentiment has been further strengthened by a challenging environment for renewable energy projects as they have experienced inflationary pressures, supply chain bottlenecks, permitting delays and the banning of offshore wind development in US federal waters. While some of these issues pre-date the Trump presidency, renewable energy developers like Orsted and EDPR have seen further declines since the beginning of the year, largely due to developments in the US and muted sentiment.

These developments, however, only tell part of the bigger story. The IEA's *Global Energy Review* 2024, released in March, highlights the accelerating transition away from fossil fuels and continued growth in renewables. The report shows that renewables accounted for the largest share of growth in global energy supply over the year (38%), followed by natural gas (28%), coal (15%), oil (11%), and nuclear (8%). In key markets like the EU, solar and wind generation surpassed coal and gas combined for the first time, while US coal consumption fell by approximately 4% to its lowest level in nearly 60 years and EU consumption dropped by 10%.

Insights from the road

Over the reporting period, Steve Kempler (Portfolio Manager & Co-founder) and Georgia Hall (ESG & Investment Director) held company research meetings with approximately 30% of our GLI strategy. They travelled to eight countries in eight days, mostly by high-speed rail to meet with senior management of some of the largest infrastructure companies in the UK and Europe. Most meetings centred around energy transition investments, physical risks and resiliency, customer affordability, energy security, defence, data centers/AI and the geopolitical environment. Many of these topics are interlinked and catalysing investment and policy prioritisation in mutually beneficial ways. As one CEO explained:

> *"When we have debates about defence, we forget to acknowledge that energy is a weapon. The focus used to be more about climate change, but now it's more about energy sovereignty. But the solution is the same because the answer is renewables and grid infrastructure."*

The realities of US trade tariffs, ongoing reliance on Russian gas and economic decoupling have forced the UK and Europe to double down on energy infrastructure planning and investments to secure energy sovereignty in the region. Energy regulators are therefore stepping up efforts to attract capital towards major transmission and interconnector projects, focusing more on timely project delivery than details of the costs.

For instance, in March, the UK electricity regulator (Ofgem) approved £4 billion of accelerated investments to fast-track the delivery of high-voltage transmission projects overseen by National Grid, SSE and ScottishPower. The UK's National Energy System Operator (NESO) has also proposed a series of grid connection reforms based on the principle of "first ready and needed, first connected". These reforms aim to optimise grid use and facilitate a more efficient transition to renewable energy sources, removing stalled projects holding up the queue.

The bigger picture

The GLI team has found that the so-called "backtracking" on ESG and climate change is mostly limited to the US, with relatively minimal spillover in other key markets such as the UK, Europe, and Australia. Firstly, key climate initiatives such as the Net Zero Asset Managers initiative and the Science-based Targets initiative, remain largely unchanged and intact in these markets. While the pace of decarbonisation has slowed at the margins, as the findings of the IEA's *Global Energy Review* demonstrates, the direction of travel remains clear. Secondly, regulatory and policy measures to incentivise the integration of ESG and climate-related factors into investment decisions and corporate disclosures have only strengthened (Australia) or been streamlined for ease of adoption (Europe). Finally, extreme weather events of 2024 have further accelerated the market's focus on adaptation and resiliency investments to future-proof infrastructure. As the CEO of one European transportation infrastructure company highlighted:

> *"We have to adapt and redesign for climate change, especially to flooding. In 2024, we had major flooding in urban areas. The motorway network has been designed for 1 in 100-year floods – but these are now happening every decade. We are talking an order of magnitude of more than EUR 70 billion of investment across all networks."*

The devastating Valencia (Spain) floods in October 2024 and the California wildfires in January 2025 further highlight the need to invest significant capital in critical infrastructure assets to adapt to a new normal.

Inflation review

A key priority of US President Trump's second term has been on introducing new tariffs to help rebalance global trade flows with the US. While the success of these tariffs will play out over the long-term, there are growing concerns that these measures will negatively affect the US domestic economy in the near- to medium-term. It is not surprising that tariffs will likely cause US inflation to rise, but IMF research has also found that based on previous experiences they also lead to reduced domestic output and productivity in the medium-term due to the inefficiencies it creates, while only having a small effect on trade balances.[1]

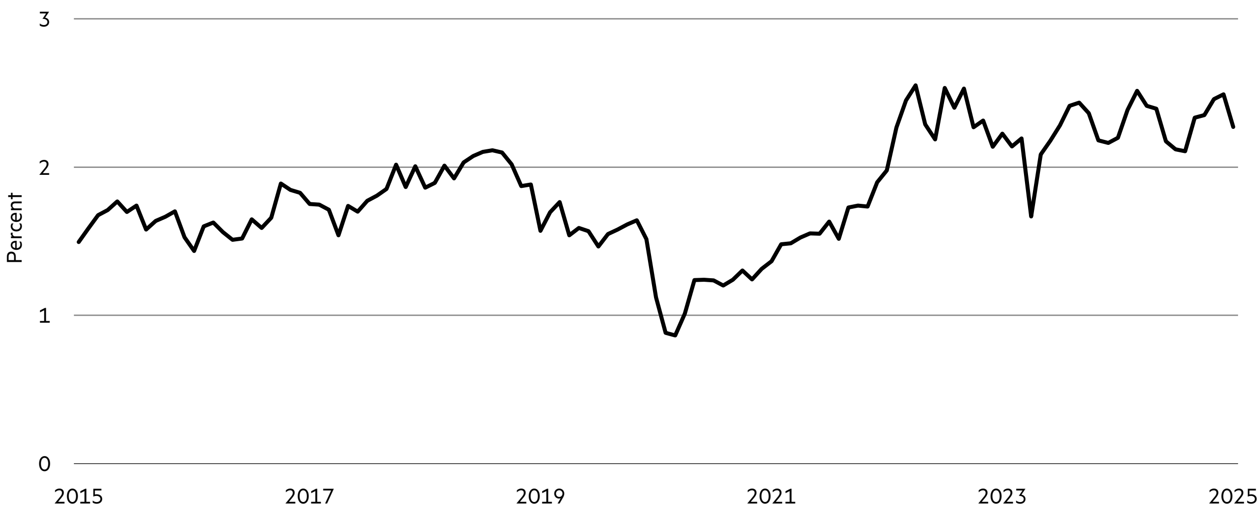
[1] Furceri D, S Hannan, J Ostry and A Rose (2019), 'Macroeconomic Consequences of Tariffs', IMF Working Papers

As a result, markets have increasingly priced in the potential for stagflation in the US, which is a period characterised by both slowing economic growth and rising inflation. While it remains too early to know for certain that the US will enter a period of stagflation and if so for how long, recent economic data have indicated that the risk appears to have increased. The extent of the economic impact will largely depend on the size and scope of the tariffs ultimately implemented, which continue to be subject to a degree of uncertainty as some countries may attempt to negotiate tariffs lower, while others may retaliate with tariffs on US imports, potentially triggering a trade war.

Heading into 2025, US economic growth appeared to be slowing on the back of higher interest rates. However, Trump's major economic policy announcements and ongoing uncertainty around some of these, particularly in relation to tariffs, appears to be weighing on growth further. Recent data points to consumption slowing as consumer confidence falls, firms' investment plans declining and monetary policy staying more hawkish than it otherwise would be due to the elevated level of uncertainty. That said, this is somewhat offset by real wages, an important driver of consumer spending, continuing to grow across all income levels.

Similarly, inflation has been moderating since the post-pandemic peak as monetary policy has remained restrictive. The introduction of new tariffs are likely to drive an inflationary shock in the near-term as consumer goods are likely to see a quick pass-through of the costs, but so far there is little evidence that this will necessarily be sustained, particularly if the Fed retains its independence. Reflecting this, the Conference Board's estimate of one year consumer inflation expectations rose to 6.2% in March, while the Federal Reserve Bank of Cleveland's estimate of the five-year expected inflation expectations moderated to 2.3% in March, which remains broadly consistent with the Fed’s inflation target.

US five-year expected inflation



Source: Federal Reserve Bank of Cleveland

In our view, while tariffs have increased the risk of stagflation in the US, the overall likelihood of prolonged and damaging stagflation remains low. Some areas of US economic growth are slowing as expected, but consumer spending appears to still be supported by continued real wage growth, while the impact from tariffs on inflation appears likely to be largely temporary in nature. Given the long-term nature of the assets in our strategy, we closely monitor these developments closely to ensure that the portfolio is appropriately positioned with companies that have strong inflation protection.

For latest Fund factsheet click here.

Fund ratings

Recommended
Lonsec Research

Zenith
HIGHLY RECOMMENDED

Morningstar Bronze

Morningstar Medalist Rating(TM)
Assigned as of 26/04/24
Analyst Driven %100
Data Coverage %100

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