A Foundation for Infrastructure

Real Assets Require Real Understanding

The Pension Investment Association of Canada's asset mix report shows alternative asset allocation has evolved over the years, says Mark Webster, Director, Institutional and Advisory, at BMO Exchange Traded Funds. He told the *Benefits and Pensions Monitor* Meetings & Events webinar 'A Foundation for Infrastructure: Real Assets Require Real Understanding' that between 16 and 23 per cent of portfolios are now allocated towards some form of alternatives with the biggest to infrastructure equity and debt. The discussion on how publicly-listed infrastructure equities can replicate many of the positive attributes found through direct investment in infrastructure also featured Chris Flynn, Head of Product Development at CEM Benchmarking, Inc.; Rupert Watts, Senior Director, Strategy Indices, at S&P Dow Jones Indices; and Vishal Bhatia, Director and Portfolio Manager at BMO Exchange Traded Funds.

Webster: What's the attraction of infrastructure as an asset class?

Flynn: The primary case for infrastructure is its attraction as a real yield asset. The generation of cash flows that are linked to inflation make it hugely attractive to pension funds. Pension funds have a desire to manage the inflation risk to cash flows they have to pay out in the future. Infrastructure is an attractive investment for that kind of liability structure.

Watts: The search for diversification and inflation protection have put the spotlight on infrastructure and funds flowing into it have grown dramatically over the past two decades. The value proposition for the asset class is that it offers attractive risk adjusted returns, stable cash flows, and a potential hedge against inflation.

But, there are compelling structural growth trends impacting infrastructure – infrastructure modernization and the global need to invest in infrastructure. And, as society becomes more digital, supporting infrastructure is needed.

These are compelling reasons to look at infrastructure right now.

Webster: How can investors gain exposure through listed infrastructure?

Watts: Listed infrastructure involves investing in publicly listed companies whose business – directly or indirectly – relates to infrastructure assets. Additionally, listed companies can provide access to unique assets that may only be available in the public markets such as airports and seaports.

The primary advantages of listed infrastructure vehicles is that they traded on an exchange, typically are more liquid, and have more transparent valuation methodologies.

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>
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Basically, there are three listed infrastructure strategies – core, broad-based, and pure play.

Core is more of an indirect exposure to assets that are economically sensitive to infrastructure related activities and services. Railways are an example.

Broad-based is an approach to security selection based on revenue exposure to infrastructure.

Pure play attempts to mimic the attributes of the underlying asset class. This approach only selects securities that derive most of their cash flows from the ownership or operation of infrastructure assets. In the Dow Jones global infrastructure family of indices, 70 per cent of the cash flows must be derived from the direct ownership or operation of infrastructure assets for a pure play.

Webster: Why are ETFs a good vehicle as opposed to a pool fund?

Bhatia: ETFs are an efficient way of deploying capital because of the partnership with the capital markets. We can deploy very significant cash flows on any given day without any impact due to the liquidity screening associated with the index construction. This ensures the names in a fund are highly liquid and the ETF can accommodate institutional-sized investments.

This makes multi-million-dollar trades one ticket trades. With one ticket, a client obtains instant geographical diversification across various industries. That is a key benefit of the listed infrastructure opportunity.

Webster: Where are the valuations and consequent yields in listed infrastructure headed?

Bhatia: They are trading just slightly above their own long-term average right now, but when you view them within a wider context – given the expectations for outsized growth from the long-term drivers and tailwinds such as global decarbonization initiatives and infrastructure spending bills – valuations and yields appear very attractive.

Webster: A lot of implementation comes from the ability of ETFs to do NAV (Net Asset Value) trades at index midpoint. Can you do it in size?

Bhatia: While ETFs have been around for a while now, there is the idea that the listed volume for an ETF is an indication of the liquidity of the underlying assets, but that's a misconception. It's really more about looking through to the liquidity of the components of the ETF to get a true sense of the tradability or investability of the product.

Liquidity for most institutionally sized cash flows is very high; we could accommodate several million shares of an ETF in the underlying equities and by utilizing the NAV mechanism, it becomes a very liquid vehicle to invest or divest funds into or out of infrastructure. And it underscores how well it can work as a complement to private assets as a liquidity buffer or sleeve.

Looking through to the liquidity of the underlying constituents and robustness of index construction are key to ensuring that the product that's linked to the index is investable. BPM

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