Infrastructure: A ballast in choppy waters

Throughout the recent volatile macro conditions, infrastructure has served as a stabilizing force in investors' portfolios given its defensive and contracted profile.

Infrastructure can be described as the building blocks of society, which we classify into three main groups:

1. economic (e.g., transport, energy, water, waste);
2. social (e.g., health, education); and
3. infrastructure 2.0 / "next generation" (e.g., energy transition, digital).

Over the past three decades, infrastructure has gained acceptance among institutional investors, evidenced by the $367 billion of committed capital yet to be deployed — this despite the challenging 2023 fundraising environment.[1] In addition, global institutional investors are around 1% under-invested to the asset class, with many expected to increase target portfolio allocations further, up from the 5% average.[2]

An inflation hedge

In recent years, infrastructure has been garnering even more attention among investors due to its ability to hedge inflation. Revenue models typically allow for periodic escalation explicitly or implicitly tied to inflation as well as cost pass-throughs to end users. For example, electric utilities often have three- to five-year rate agreements (i.e., what they can charge customers based on an allowable return on equity) as set by regulators combined with power generation revenues typically driven by market power prices. Aside from the inherent inflation linkages, other attractive attributes of the asset class include:

- Long duration, cash generative nature
- Assets providing essential services, creating inelastic demand profiles less linked to the business cycle (e.g., people need water and students attend school regardless of economic conditions)
- Monopolistic supply characteristics and high barriers to entry (e.g., difficulty building competing railway lines or marine ports)
- Unique return drivers determined by regulation, concession agreements, contracts or local economic activity

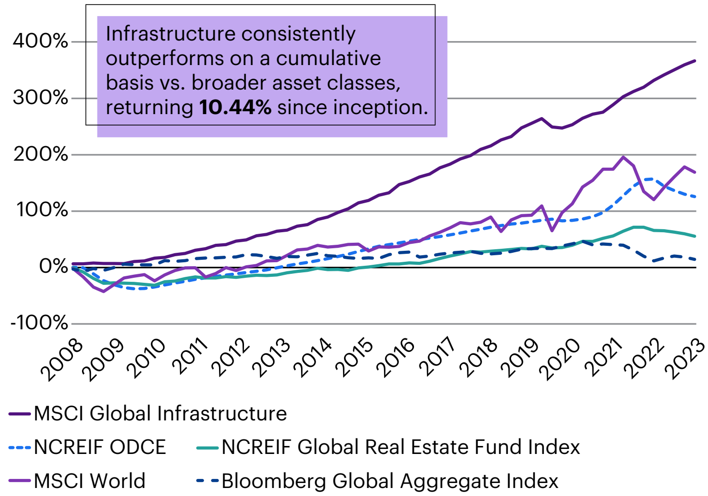
Private infrastructure has generated strong performance versus private real estate

These unique characteristics have enabled infrastructure to produce stable, noncorrelated performance versus traditional asset classes. According to the MSCI Global Quarterly Private Infrastructure Index, a benchmark that represents the global private infrastructure landscape, **private infrastructure has returned 10.44% since inception of the index compared with the NCREIF ODCE with 5.40% and NCREIF Global Real Estate Fund Index with 2.89%**. Figure 1 further illustrates performance of real estate versus broader asset markets.[3] In addition, given infrastructure assets' long-term useful lives and debt tenors, valuation assumptions are less sensitive to short-term interest rate fluctuations versus other private markets assets. For instance, private core infrastructure discount rates held relatively steady throughout the past four years compared other segments such as private core real estate which are currently resetting higher from the early 2022 lows (i.e., putting downward pressure on underlying asset valuations).

Opportunities ahead

Looking ahead, our focus will remain on areas of the market benefiting from thematic demand drivers projected to remain in place over the foreseeable future. Examples include global connectivity (digital), environmental issues (energy transition) and demographics (economic, social, energy security).

Figure 1. **Infrastructure Performance vs. Broader Markets June 2008 – Sept. 2023**



Source: eVestment

If you have any questions or would like to know more, please contact us here.

1 Preqin as of March 2024
2 Cornell University, Hodes & Weill, 2023 Infrastructure Allocations Monitor
3 MSCI Global Quarterly Private Infrastructure Asset Index as of September 30, 2023. Inception of the index is June 2008. NCREIF ODCE is the NCREIF Open-End Diversified Core Equity Index and represents US Private Real Estate, and NCREIF Global Real Estate Fund Index (GREFI) represents Global Private Real Estate. MSCI World Index represents Global Equities, and Bloomberg Global Aggregate Index represents Global Fixed Income.

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WTW-145841/04/24

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