



# Cohen & Steers Capital Management

Recently, **Drew Campbell**, senior editor of Institutional Investing in Infrastructure, spoke with **Bob Becker** and **Ben Morton** of Cohen & Steers Capital Management about global listed infrastructure markets. The following is an excerpt of that conversation.

*Why should investors have a separate allocation to global listed infrastructure?*

**Becker:** The listed markets offer a liquid way to invest in premier infrastructure assets owned by public companies with strong management teams and effective corporate governance. Investors are drawn to the total return potential, relative stability, diversification and global reach that characterize companies in this sector.

Listed infrastructure companies benefit from their generally monopolistic operations and, often, inflation-linked cash flows. Given these characteristics, they tend to offer attractive and stable income with predictable cash-flow growth potential. Over the long term, the asset class has shown low levels of relative volatility and low correlations with the broad equity and fixed income markets.

**Morton:** The need for infrastructure investment and maintenance over the next 20 years tops \$40 trillion. The effects of underinvestment can lead to high returns on assets and drive privatizations. Increasingly, institutional investors are complementing their direct infrastructure allocations with listed infrastructure investments that offer greater liquidity and diversification.

*What are some of the factors driving the growth in infrastructure investment?*

**Morton:** Infrastructure spending has been the centerpiece of global



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stimulus packages. Spending in developed markets is driven by a history of underinvestment, which has led to antiquated networks (e.g. electricity transmission, roads) badly in need of upgrading. In the developing world, investment stems more from urbanization and a rising standard of living. Recently, reliance on the private sector to provide infrastructure services has increased worldwide with government fiscal constraints. Importantly, governments and regulators understand that the only way to incentivize private-sector infrastructure investments is to allow attractive rates of return on those investments.

*Do you invest in emerging markets?*

**Becker:** Emerging markets, which have a market cap of roughly \$150 billion, are a very important part of our universe. Several important criteria are acceptable — corporate governance standards, improving regulatory transparency and sufficient liquidity — all of which we see in Brazil and China.

*What is your target investment universe?*

**Morton:** We target asset owners with predictable cash flows, which lead to low long-term equity market correlations. Our universe of 300-plus companies has a market cap of approximately \$1.7 trillion. Subsectors range from utilities (gas, electric, water) to transportation (toll roads, airports, marine ports, passenger railways) and telecommunications (cellular tower and satellite companies).

Some managers include more peripheral subsectors, such as engineering, construction and materials. However, they tend to be highly cyclical and correlated to broad equity markets — two characteristics we generally avoid in our search for predictable cash flows and inflation protection.

*What do you think sets you apart from other global infrastructure managers?*

**Becker:** First is our dedicated infrastructure team that averages 11 years of infrastructure investment and research experience. Our

longstanding expertise in analyzing regulatory environments is critical, as regulation is arguably the biggest risk in this sector.

Second is our perspective as a leader in the listed real estate asset management space, which has many parallels with infrastructure. Cohen & Steers specializes in both of these strategies.

Third is our scale — over \$2.3 billion in listed infrastructure — which gives us access to management teams and regulators.

Fourth is our strong performance record, driven by a disciplined approach that combines top-down and bottom-up processes. Finally, we are an independent, public company with broad equity ownership among employees.

#### *How is your team structured?*

**Morton:** Our team of two portfolio managers and three analysts is organized to invest globally. The analysts based in the U.S. and Hong Kong focus on specific geographies and subsectors. Meeting with management teams and regulators is an important part of their process. Analysts construct a detailed financial model for each company, with relevant valuation metrics. Bob's and my work as portfolio managers, in conjunction with the other global teams at Cohen & Steers, provides the macroeconomic and commodity price inputs for these models.

#### *Describe your investment process.*

**Morton:** First we screen our universe of companies, primarily those in regulated industries with monopolistic businesses and high barriers to entry. Then we analyze each company's asset profile, balance sheet, management track record and regulatory environment. Valuation work is conducted by the analysts as they build and maintain their company-level financial models.

The next step is portfolio

construction, which combines a top-down approach (our positioning by subsector) with a bottom-up approach (focused on relative value at the security level within each subsector). This model helps determine the relative attractiveness of each subsector according to our current outlook for key macro drivers — fundamentals, credit cycle, economic cycle, commodity cycle. From this we determine subsector overweights and underweights, and populate each subsector by determining security-level relative value, using the analysts' bottom-up financial valuation work.

#### *What were some of the factors that drove performance for your infrastructure portfolios in 2010?*

**Becker:** Global equities, including infrastructure, had a good year despite headline macroeconomic events. Our underweight in Europe added value, as the debt crisis in southern Europe disproportionately hurt infrastructure across the continent — especially utilities and toll road companies. We also benefited from an underweight in Japan, specifically in railways. Our overweight in developing regions with strong economies, such as Brazil and China, helped.

**Morton:** On a sector level, we benefited from an underweight in integrated utilities, hurt by low power prices and a heightened level of political intervention in Europe. Our overweight in pipeline companies, largely in the Americas, helped as well. But our underweight in airports was a negative; we underestimated the operating leverage airports had to strengthening economic conditions.

#### *At this time, where do you see opportunity in infrastructure companies?*

**Morton:** One of our favorite subsectors is pipelines — particularly in North America, which must completely redesign its pipeline grid to connect consuming regions to developing sources of oil and

gas (e.g. shale plays in the Rockies and Appalachia, the Canadian oil sands, and the deepwater Gulf of Mexico). Pipelines benefit from long-term contracts, federal-level regulation and attractive allowed rates of return.

**Becker:** Although we predominantly invest in developed markets, we see interesting opportunities in the emerging world. For example, Brazil is benefiting from powerful demographic trends driven by urbanization and rising standards of living, as well as infrastructure investment for the upcoming World Cup and Olympics. And the government is encouraging private infrastructure investment. Brazil offers investment opportunities across the spectrum, from toll roads and ports to electric utilities and water companies.

#### *What is your outlook for global listed infrastructure?*

**Becker:** Our outlook is positive, based on a few factors. First, of course, is the economic recovery, which is driving throughput growth such as traffic and energy demand. And regulation remains constructive, especially given the need for governments to incentivize private sector investment.

Deleveraging has improved balance sheets, and companies are now well positioned for the infrastructure spending boom we are predicting. The majority of infrastructure cash flows are linked to inflation — toll roads, for instance, which generally can raise tolls every year by a rate linked to inflation.

**Morton:** Listed infrastructure valuations are attractive, with our universe trading at roughly a 10 percent to 15 percent discount to net asset values, versus 0 percent to 5 percent, historically. Given an average 4 percent dividend yield coupled with 6 percent average long-term cash flow growth potential, we expect long-term annual total returns to approach 10 percent. ♦

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