

Taking Stock in Global Infrastructure Opportunities

by **Robert Becker** and **Benjamin Morton**, senior vice presidents and portfolio managers



Robert Becker

Global infrastructure is an increasingly attractive investment opportunity with the ongoing coalescence of three themes: the inherent characteristics that define the asset class; the massive need to invest in new infrastructure and upgrade aging assets; and the privatizations of infrastructure assets, as governments seek to manage their budgets and recapitalize stretched balance sheets. Over the next 20 years, we could see \$40 trillion spent on infrastructure, spread globally across a wide range of businesses in the transportation, energy, utilities and communications industries:

INFRASTRUCTURE SUBSECTORS IN DEVELOPED AND EMERGING ECONOMIES

Transportation	Energy	Utilities	Communications
Toll Roads	Storage and Transportation	Electric Utilities	Wireless Towers
Airports	Renewable Energy	Gas Utilities	Satellite Services
Marine Ports		Water	



Benjamin Morton

As this issue of *Viewpoint* conveys, we think investors will be the prime beneficiaries of this shift in ownership, as we ask the questions, “Why Infrastructure?” and “Why Listed Infrastructure Now?” Inside you’ll find our perspective, supported by the research of the Cohen & Steers investment team. We also frame two investable themes, through industry case studies on developed and emerging market opportunities.

Infrastructure assets tend to be long-lived, with high barriers to entry, monopolistic operations and inelastic demand.

Why Infrastructure?

Stable Income and Growth

Investors often turn to infrastructure securities for their stability of income and growth potential. Contributing to these attributes are four basic characteristics:

1. **Long lived assets**—Electrical grids, natural gas pipelines, water treatment plants, toll roads and wireless towers are just a few examples.
2. **High barriers to entry**—Strict zoning restrictions and large capital requirements make it difficult or prohibitive for competitors to enter the market; increasing the value of existing assets.
3. **Monopolistic structure**—The regulated nature of infrastructure companies can serve to enhance cash flow predictability and lower financial risk. However, these companies can also become targets of austerity measures in periods of less stable regulatory, economic or political environments.
4. **Inelastic demand**—Infrastructure provides essential services that tend to be resistant to economic downturns.

Infrastructure capital investment is resilient, even during times of economic difficulty.

Infrastructure companies generally remain near the top of the pecking order in terms of access to capital, given their relatively strong balance sheets, predictable cash flows and regulated business models. Utilities, for example, were successful in issuing significant amounts of

both debt and equity in 2009, when access to capital was limited for most businesses.

Low Correlation with Global Equities

Over the long term, the correlation of infrastructure securities with global equities has been relatively low. But during the recent financial crisis, correlations rose as the high cost and lower availability of debt caused asset values to decline.⁽¹⁾ Since that time, there has been meaningful deleveraging, and we have begun to see evidence of declining correlations. Over time, we think this trend may be furthered by the increasing prevalence of infrastructure security structures focused on income delivery, such as REITs (e.g., cell towers, energy transmission) and MLPs (e.g., pipelines).

Lower Volatility Than Broader Equity Markets

As shown in Exhibit 1, the volatility of infrastructure securities has also declined to historic pre-crisis levels. However, it's important to note that the performance of individual subsectors will vary significantly over time, as each responds differently to credit market and economic conditions. This can create opportunities for active managers who understand the macro drivers of these businesses.

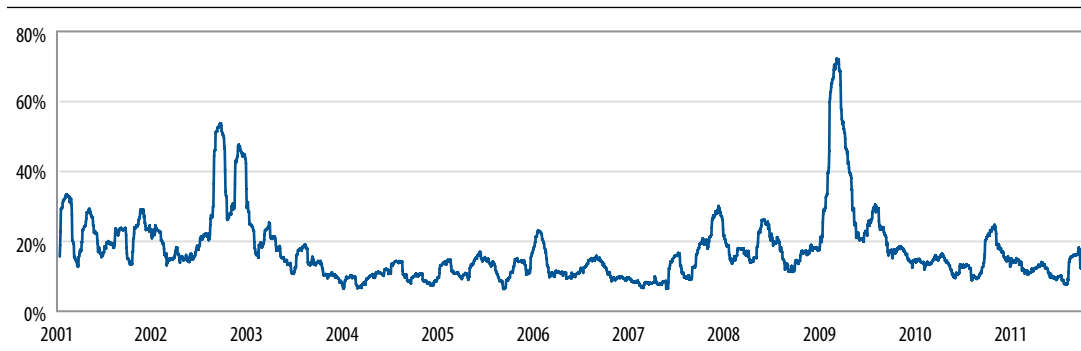
Predictable Revenue, Often Linked to Inflation

The contractual nature of revenues, combined with the ability to pass on higher costs, allows companies to maintain real revenue growth and enhance the likelihood of long-term outperformance and inflation protection.

(1) Source: Morningstar Direct and Cohen & Steers as of April 29, 2011. For the 10-year period ended 4/29/11, the correlation of global infrastructure securities with the MSCI World Index averaged 0.72. During the 2008–2009 financial crisis, correlations rose to an average of 0.90. Infrastructure securities are represented by a linked benchmark, using the S&P 1500 Utilities Index prior to October 2008, and the UBS Global 50/50 Infrastructure & Utilities Index thereafter. See index definitions at the end of this publication.

EXHIBIT 1. GLOBAL INFRASTRUCTURE COMPANIES: ROLLING 30-DAY VOLATILITY

2001–2011



As of April 29, 2011.

Source: Morningstar Direct and Cohen & Steers.

Past performance is no guarantee of future results.

Infrastructure is represented by a linked benchmark, using the S&P 1500 Utilities Index prior to October 2008, and the UBS Global 50/50 Infrastructure & Utilities Index thereafter. See index definitions at the end of this publication.

Diversification by Asset Class, Subsector and Geography

Investing in infrastructure offers diversification opportunities at the asset class, portfolio and individual security levels. With a portfolio of 50 to 90 securities, investors gain access to all infrastructure subsectors and geographies.

At the security level, companies typically own several, if not dozens, of infrastructure assets, offering further diversification. Broad diversification is critical for several reasons:

- Since regulation is, in our view, the largest risk faced by the asset class, exposure to diversified regulatory and political environments can be beneficial.
- Diversification can reduce volatility related to varying regional economic and market conditions.
- Country risks can lead to dramatically different asset and market performance, as seen in 2010 during the sovereign credits crises in peripheral Europe.

The volatility of infrastructure securities has returned to pre-crisis levels.

Diversification can help mitigate regulatory, sovereign and market risks.

Developed economies suffer from massive underinvestment in infrastructure.

Why Infrastructure Now?

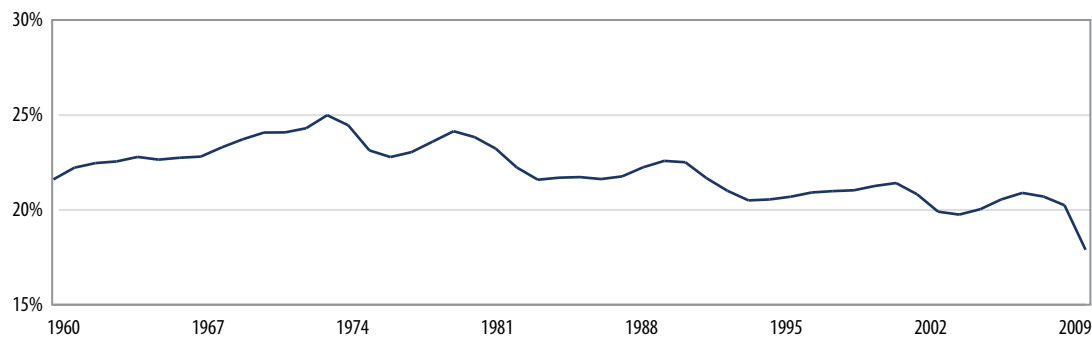
Developed Markets: A History of Underinvestment

The opportunity for infrastructure investment in developed economies is framed by a steady, 50-year decline in infrastructure spending, as a percentage of GDP. In Europe, utilities alone could spend nearly US\$1.3 trillion between 2010 and 2020,⁽¹⁾ as they respond to government-imposed environmental regulations and embark on a large-scale asset replacement cycle.

According to the American Society of Civil Engineers (ASCE), U.S. infrastructure spending could exceed \$2 trillion over the next five years, based on the poor condition and performance of infrastructure assets across a wide range of subsectors.

One area that stands out as an investment opportunity is U.S. cell tower companies, as we describe in the “Case in Point” on the following page.

EXHIBIT 2. INFRASTRUCTURE INVESTMENT CAPITAL AS A PERCENT OF GDP HAS BEEN DECLINING



As of December 31, 2009.
Source: Goldman Sachs. Note: Gross fixed capital formation was used as a proxy for infrastructure spending.

EXHIBIT 3. INFRASTRUCTURE SUBSECTORS

Poor Grades from the American Society of Civil Engineers (ASCE)

Subject	2009 Grade	Comments
Aviation	D	Airports are challenged by rising numbers of regional and new super-jumbo jets.
Bridges	C	160,000 deficient bridges could cost \$9.4 billion annually for 20 years.
Dams	D	Critical non-federal dams could cost \$10+ billion over the next 12 years.
Drinking Water	D-	There is an \$11 billion annual shortfall to replace facilities and comply with regulations.
Energy (national grid)	D+	Growing electricity demand and new power plant investments require new transmission facilities.
Navigable Waterways	D-	Barge transport is very economical, but replacing the functionally obsolete system of locks could cost up to \$125 billion.
Rail	C-	Costs could reach \$175–\$195 billion over the next 20 years.
Roads	D-	Poor road conditions cost U.S. motorists \$54 billion a year.
Transit	D	Government infrastructure spending led to a significant rise in transit use during the 1990’s, but reduced federal spending in real dollars since 2001 threatens this turnaround.

As of December 31, 2009.
Source: American Society of Civil Engineers. (Categories evaluated by ASCE based on condition and performance, capacity vs. need, and funding vs. need.)

(1) Source: Citigroup Global Markets as of December 31, 2010.
(2) Estimated five-year need—does not include security investment needs.

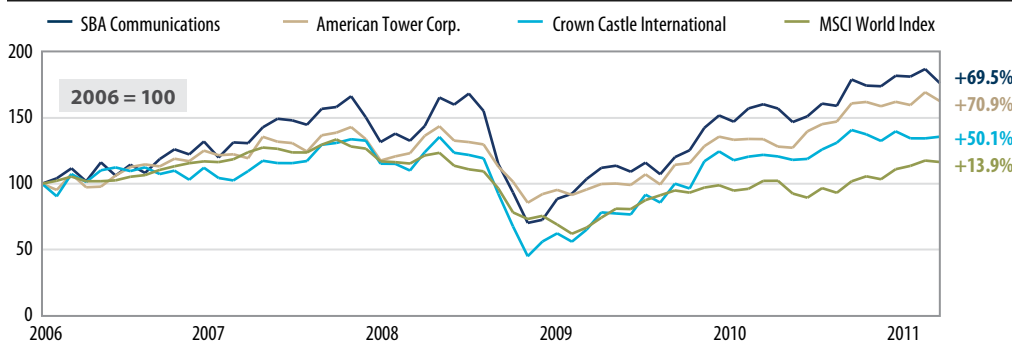
Correcting the “D” grade on the quality of U.S. infrastructure assets could require a \$2.2 trillion capital investment.⁽²⁾

CASE IN POINT: U.S. Tower Companies

U.S. cellular tower companies, which own towers and lease equipment space to telecommunication carriers, have attractive business models and stable cash flows. Leases average 10 years, have low churn and generally include annual inflation-linked revenue escalators. Because tower operating and maintenance costs are modest and fixed operating leverage is high, new leases and revenue escalations flow directly to the bottom line. Exhibit A below compares the five-year total returns of the three U.S.-listed tower companies to that of the MSCI World Index.

EXHIBIT A. FIVE-YEAR TOTAL RETURNS

U.S. Cell Tower Companies vs. the MSCI World Index



As of March 31, 2011.

Source: Bloomberg.

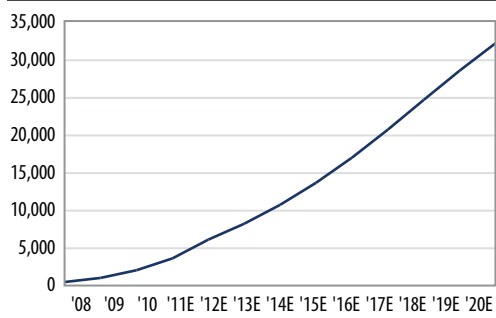
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The case for tower companies revolves around the increasingly data-intensive nature of wireless devices (e.g., iPhones, iPads, Blackberries), as well as the increased penetration of those devices; data usage in the United States has grown 16% annually from 2007–2010 and is expected to grow at 22% per year through 2020. The current U.S. wireless infrastructure is insufficient to meet this demand, which is forcing carriers to invest heavily in their networks.

EXHIBIT B. U.S. WIRELESS DATA USAGE

Data MOU Equivalents (in billions)

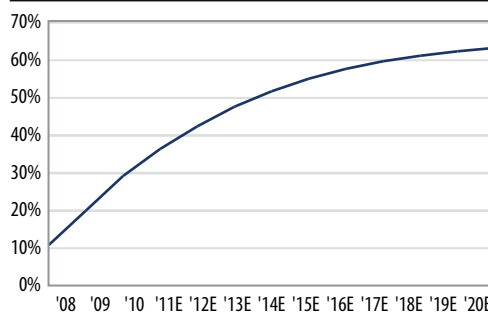


As of February 28, 2011.

Source: Goldman Sachs.

MOU = Minutes of Usage.

EXHIBIT C. U.S. SMARTPHONE PENETRATION



As of February 28, 2011.

Source: Goldman Sachs.

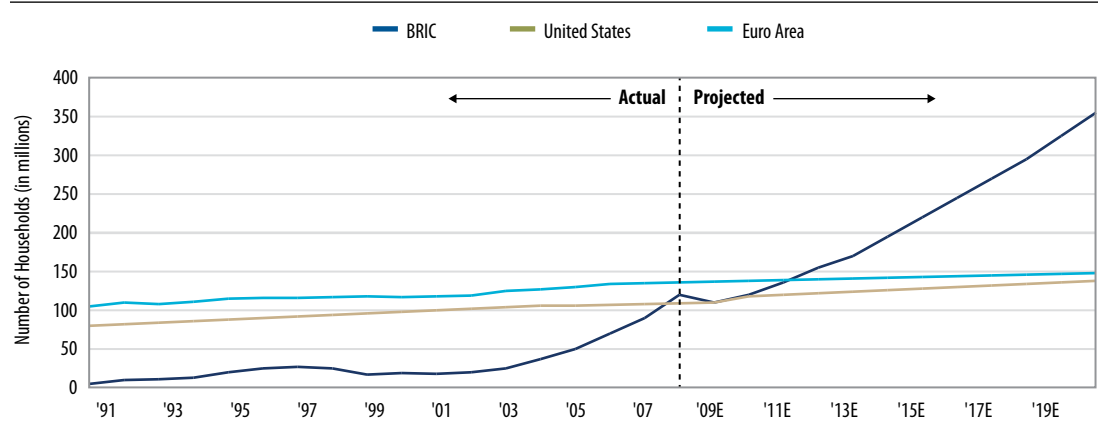
Urbanization and rising standards of living are driving infrastructure spending in emerging economies.

Emerging Markets: Demographic Shifts Drive Infrastructure Investment

The demand for new infrastructure is most pronounced in developing economies, where powerful demographic trends—particularly urbanization and rising standards of living—have led to increased spending. Exhibit 4 illustrates this trend in the BRIC countries (Brazil, Russia, India and China), using a

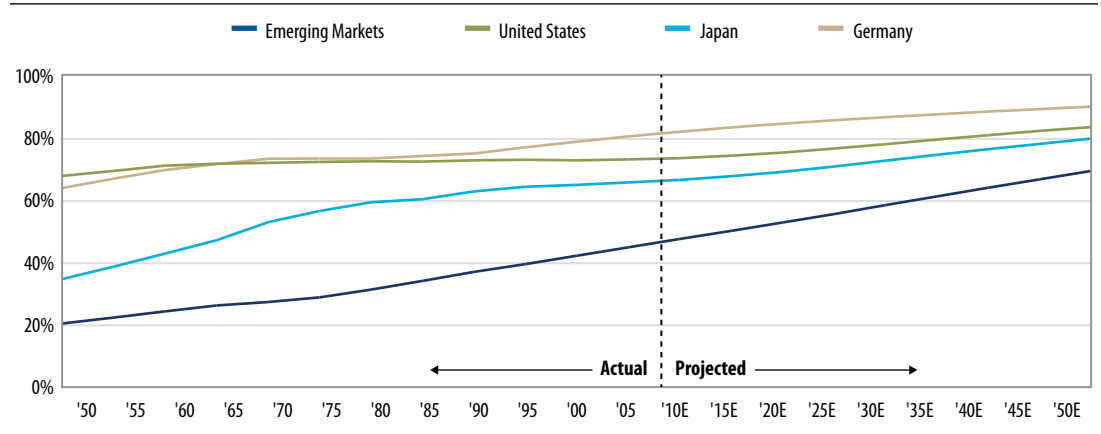
long-term comparison of their historical and projected disposable income relative to that in the United States and Europe. The sweeping effects of rising incomes are transforming modes of transportation, with car ownership and air travel becoming more prevalent as personal wealth grows.

EXHIBIT 4. INCOMES ARE RISING AT A FASTER PACE IN EMERGING MARKETS
 Disposable Income Over \$10,000



As of March 31, 2010.
 Source: Euromonitor, Morgan Stanley Research.

EXHIBIT 5. URBANIZATION IS DRIVING EMERGING MARKET GROWTH
 Percentage of Urban Population



As of December 31, 2010.
 Source: Morgan Stanley Research, UNPD.

But, between emerging and developed countries, there is still an enormous disparity in their respective access to basic services. In India, for example, the number of passenger vehicles per capita amounts to just 2% that of the United States. Air passenger travel in Russia and Brazil is at only about 10% of U.S. levels; per capita electricity consumption in China is only about 15% of U.S. consumption.⁽¹⁾ The assessment in Exhibit 5 of urban population trends, looking back to 1950 and projecting forward to 2050, suggests that urban growth in emerging markets will accelerate in the 21st century. This should mirror increases in disposable income, which in turn, should drive growth in demand for infrastructure services. In the next “Case in Point” we highlight toll

road operators in Brazil and China as attractive ways to access these emerging market trends.

The Turn to the Private Sector

The global recession has reduced government revenues, leading many global municipal, state and federal governments to announce plans to reduce deficits through infrastructure asset sales.

Listed infrastructure companies with strong balance sheets and access to capital markets are in a solid position to help finance these privatizations. Importantly, governments understand that management teams will seek out projects with reasonable allowed rates of return and regulatory transparency.

Between emerging and developed economies, there is still a significant disparity in access to basic infrastructure services.

EXHIBIT 6. RECENT ANNOUNCEMENTS TO PRIVATIZE GOVERNMENT INFRASTRUCTURE ASSETS

Date	Country	Target Amount	Infrastructure-Related Assets for Sale
6/2/2009	Australia (Queensland)	A\$15.0B	Rails, ports, forestry
10/12/2009	United Kingdom	£16.0B	Rails, aviation, postal assets
3/16/2010	Portugal	€6.0B	Transport, energy, communications, mining
7/14/2010	Lithuania	\$6.6B	Energy, transport, industrials
7/23/2010	Ireland	Not disclosed	Airports, rails, ports, utilities
9/30/2010	Greece	€3.0B	Railways, water companies, marinas, airports, other infrastructure
10/1/2010	India	\$8.9B	Shipping, oil, coal
10/6/2010	France	Not disclosed	Regional airports
10/26/2010	Turkey	\$5.0B	Bridges, toll roads
11/17/2010	Russia	\$31.9B	Oil, rails, airlines, shipping, utilities
11/30/2010	India	Not disclosed	Shipping, oil, coal
12/1/2010	Spain	€9.0B	Airports
1/26/2011	New Zealand	NZ\$6.8B	Energy, transport

As of January 31, 2011.
Source: Cohen & Steers.

Governments are selling infrastructure assets as a means of contributing to the paydown of sovereign debt.

(1) Source: Goldman Sachs.

CASE IN POINT: Emerging Market Opportunities in Toll Road Operators

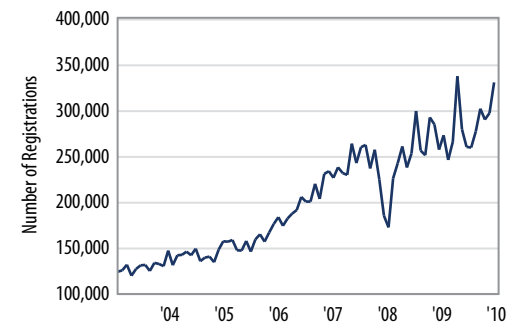
Emerging markets infrastructure growth is another compelling theme easily accessible to listed infrastructure investors. Brazil, for example, is in the early stages of a rapid increase in infrastructure investment. There was substantial underinvestment during the 1980–1990s, followed by strong economic growth. Automobile ownership is increasing rapidly, along with trends of urbanization. Growth is also being spurred by the upcoming 2014 World Cup and the 2016 Olympics. One beneficiary of this trend will be toll road operators, of which there are several listed in Brazil.

Rising vehicle ownership in China is also a powerful and investable theme, given the size of its economy and a currently low ownership rate. Exhibit B to the right shows the acceleration in ownership seen since 2008. Today, Chinese toll roads have an average dividend yield of 4%, with cash flows benefiting from double-digit traffic growth.

Exhibit C lists some of the listed toll road companies in China and Brazil, many of which pay attractive dividends.

EXHIBIT A. BRAZIL: MONTHLY DOMESTIC VEHICLE REGISTRATIONS

(units seasonally adjusted)

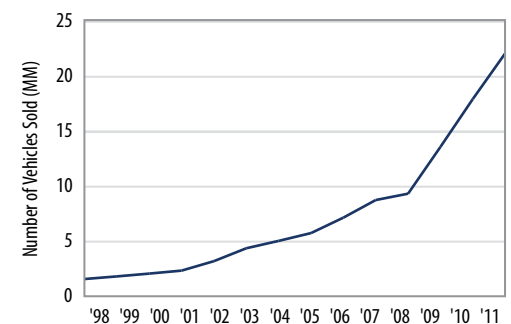


As of December 31, 2010.

Source: Fenabrave, Goldman Sachs.

EXHIBIT B. CHINA: MILLIONS OF VEHICLES SOLD ANNUALLY

1998–2011



As of February 28, 2011.

Source: ISI.

EXHIBIT C. LISTED TOLL ROAD COMPANIES: BRAZIL AND CHINA

Name	Ticker	Country	Market Cap (US\$ MM)	Dividend Yield
Obrascon Huarte Lain Brasil	OHLB3.BZ	Brazil	2,431	1.0%
CCR SA	CCRO3.BZ	Brazil	12,639	4.0%
EcoRodovias	ECOR3.BZ	Brazil	4,293	3.3%
Shenzhen Expressway	548.HK	China	1,569	4.0%
Anhui Expressway	995.HK	China	1,506	3.6%
Jiangsu Expressway	177.HK	China	5,045	5.0%
Sichuan Expressway	107.HK	China	2,757	1.7%
Zhejiang Expressway	576.HK	China	3,832	4.8%
GZI Transport	1052.HK	China	882	5.8%

As of February 28, 2011.

Source: Bloomberg, Cohen & Steers.

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Our Closing Perspective

Investors have long turned to infrastructure companies for cash flow stability and balance sheet strength. The essential services they provide make them relatively resistant to economic downturns. In periods of rising inflation, many of these companies can pass along higher costs, allowing them to maintain real revenue growth.

Many companies are reinvesting free cash flow to build future income streams, reflective of today's early stage in the infrastructure investment cycle. As this cycle matures, however, we anticipate a rising focus on delivering income to investors. Some companies will reorganize structurally as tax-efficient investment vehicles designed for income delivery, such as Real Estate Investment Trusts (REITs) and Master Limited Partnerships (MLPs). We are already seeing these types of conversions among U.S. cellular tower and energy transmission companies, as well as marine ports.

Across developed and emerging markets, listed infrastructure companies provide ease of access to a broad spectrum of industries and geographies. Some investors view infrastructure as a carve-out from their global equities allocation, recognizing the strategy's equity characteristics while appreciating its defensive attributes. Others place infrastructure in a "real assets" allocation, recognizing the unique asset profiles, inflation linkages and long-term performance of the underlying businesses.

Within either asset allocation framework, we see listed infrastructure as an attractive total return proposition. The asset class is characterized by stable, predictable dividends, averaging about 4% across the universe. Combining this with our 6% estimate of long-term cash flow growth, we believe average annual total returns could approximate 10% over the next five years.

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Risks of Investing in Global Infrastructure Securities: Investments in global infrastructure securities will be more susceptible to adverse economic and regulatory occurrences affecting this industry sector. Infrastructure issuers may be subject to regulation by various governmental authorities and may also be affected by governmental regulation of rates charged to customers, operational or other mishaps, tariffs and changes in tax laws, regulatory policies and accounting standards. Foreign securities involve special risks, including currency fluctuation and lower liquidity. Some global securities may represent small and medium-sized companies, which may be more susceptible to price volatility than larger companies.

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Index Definitions

The MSCI World Index consists of a wide selection of stocks traded in 23 developed countries. It is weighted for market capitalization and is considered an important benchmark of the state of global stock markets.

The S&P 1500 Utilities Index is an unmanaged market capitalization weighted index of 82 companies whose primary business involves the generation, transmission and/or distribution of electricity and/or natural gas.

The UBS Global 50/50 Infrastructure & Utilities Index (net of dividend withholding taxes) tracks a 50% exposure to the global developed market utilities sector and a 50% exposure to the global developed market infrastructure sector. The utilities sector excludes the sub-sector generation utilities. The index is free float market capitalization weighted and is reconstituted annually with quarterly rebalances.

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