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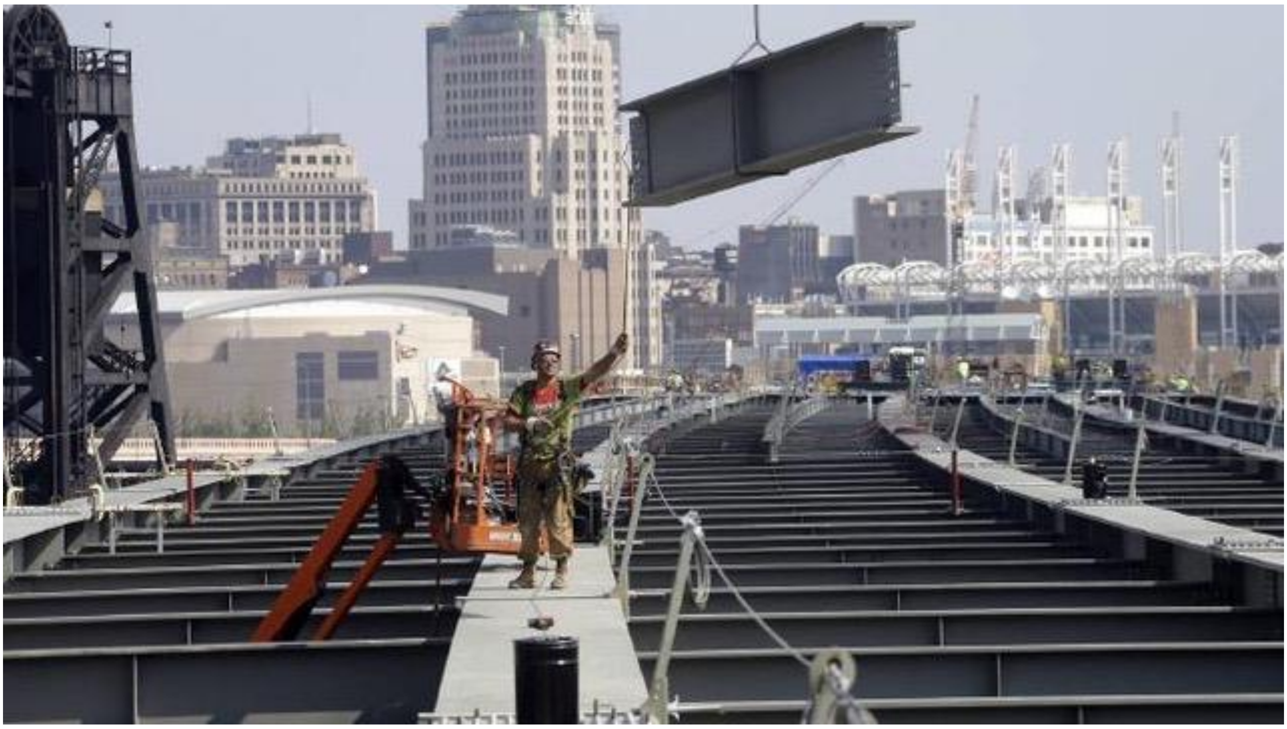
The Australian
12:00AM April 18, 2017

Getting into the Trump infrastructure upswing



The Trump administration is keen to fund infrastructure with a combination of public and private money.

Retail investors have long searched for ways to invest in infrastructure: it is, perhaps, the area of investing where bigger investors really have an advantage.

More recently, with news that Donald Trump is considering an acceleration of his $US1 trillion ($1.3 trillion) infrastructure plan in the US, the desire to get a piece of infrastructure action is stronger than ever.

Investors have often focused on shares because of their accessibility, familiarity and tax-effective income, but there are options to traditional asset classes.

Alternative investments can have the characteristics of a consistent return and lower volatility. Some alternative investments include infrastructure, marketplace loans, currency, commodities, real assets and real estate.

The key pathway into infrastructure for retail investors are global infrastructure funds or exchange traded funds. Global infrastructure has attractive qualities of stability and defensiveness.

The bright outlook for global infrastructure development is supported by a recent report by PwC predicting that by 2020, annual global infrastructure spending will reach $US5.3 trillion, up from an estimated $US4.3 trillion in 2015.

A hard landing in China could wipe $US1 trillion off the total spend, but then increased spending in the US on the back of political support would negate that.

There are a range of infrastructure assets held by global infrastructure funds, such as water and sewerage utilities, distribution pipelines and transmission wires; toll roads, airports, ports and railways; and communications, power generation and energy providers. The appeal of infrastructure investments include:
• Predictable demand, which is independent of economic conditions, and more dependent on politics;
• Attractive yields are supported by predictable long-term investments, cash flows, and earnings;
• Indexed income so may provide some inflation protection; and
• Low correlation to other investment sectors (in other words infrastructure should not rise and fall in tandem with traditional shares).

A commonly held belief is that rising rates hurt infrastructure companies. A recent rise in the 10-year bond yields post the election of Trump did cause weakness in infrastructure investments. But, the inflation protection of infrastructure assets with regulated prices, which includes utilities, will provide some relief with earnings improving when interest rates and inflation rise.

What’s more, rising interest rates can be indicative of a growing economy, so railways and airports will benefit from increased consumer demand.

During market volatility infrastructure assets can be defensive as seen during the GFC, when the majority of infrastructure companies fell less than the overall markets.

One of the easiest ways retail investors can access alternative investments such as infrastructure is through a managed fund. But, the latest Standard & Poor’s index versus active or SPIVA scorecard reveals that many active managers underperformed their respective benchmarks.

There are some keys points when choosing a fund manager:

Fees: The compounding effect of high fees over time can significantly reduce returns, especially when low interest rates are also reducing income. High fees can extract most of the outperformance by a fund.

Index-like approach: If the manager is investing in almost every stock in the benchmark, look for the low-cost delivery more typical of an index fund or an ETF performing the same function.

Benchmark: The benchmark used by the fund should be representative of what the fund is trying to achieve.

Currency: Global investments can be hedged or unhedged — hedging to the Australian dollar removes currency fluctuations.

Risk management: Diversification of many stocks and countries (subject to the benchmark's constituents) will protect against specific risk related to a particular industry, company or country.

Funds that charge among the lowest fees for infrastructure funds include Redpoint Global Infrastructure Fund and VanEck Vectors FTSE Global Infrastructure (hedged) ETF, charging a management fee of 0.7 per cent and 0.5 per cent respectively.

Redpoint Global Infrastructure Fund is available on the mFund service on the ASX, making it easier to buy and sell units. The fund invests in about 118 - listed infrastructure companies out of 151 holdings in the benchmark.

The fund's fees are lower than most actively managed global infrastructure funds. Eric Smith, chief investment officer of Redpoint, says that the lower fee is possible because of Redpoint's quantitative approach. This approach seeks to reduce the concentrations in the top 10 stocks in the index from 31 per cent to 16 per cent, as well as eliminating poor quality and excessively leveraged stocks, and overweighting the portfolio towards those with higher, sustainable yields.

Another way to access the asset class is through an ETF. There are limited options available but VanEck Vectors FTSE global infrastructure (hedged) has the lowest fees, but has a short history of less than one year.

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