

# Key themes for 2021

## Infrastructure Outlook



## Light at the end of the tunnel?

2 | Macroeconomic  
overview

3 | State of the infrastructure  
market and outlook

5 | Key sectors  
deep dive

9 | Private  
infrastructure markets

# Top investment themes in infrastructure

As we approach the end of 2020, the infrastructure sector looks to have weathered the COVID-19 crisis reasonably well. While certain sub-sectors were severely impacted, 1Q20 valuations for the sector were more resilient than other alternative asset classes and infrastructure companies saw fewer downgrades and defaults than their equivalent corporates. With a vaccine in sight, policy makers will continue to focus on how to support the economy in the interim. Fiscal stimulus looks like an attractive proposition. Government spending is likely to be directed towards supporting jobs while also investing in healthcare, decarbonization and digital infrastructure, potentially providing a boon for infrastructure investors.

## Macroeconomic overview

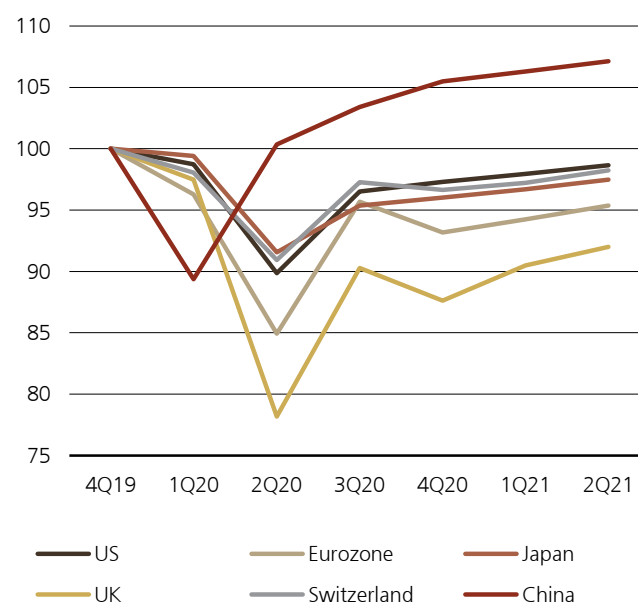
COVID-19 continues to have a pervasive global impact with many US states and European countries implementing new lockdowns, with some at the national level. Indeed, the latest economic forecasts are for some countries to slip back into negative growth in 4Q20 (see Figure 1). A sustained recovery in 2021 will rely on a vaccine becoming widely available. Trial results released so far have found the Pfizer-BioNTech, Moderna and AstraZeneca-Oxford vaccines to be highly effective. Three conditions must be met for a vaccine to be successful. First, it must be possible to rapidly manufacture and distribute a vaccine at scale. Second, governments and health systems must be able to effectively organize inoculation for the targeted population. Finally, the population must have the confidence in and be willing to take a vaccine which has been developed at record speed.

Governments and central banks were quick to support their economies at the start of the pandemic. They implemented new spending programs, cut interest rates to zero, and implemented new QE spending – for the first time in some countries such as Australia and Canada – and introduced new lending programs for businesses in need. However, as the second wave of the virus hits, governments and central banks have less ammunition.

The IMF is not recommending a rush to austerity to pay off increased debt once the pandemic has ended. Nominal GDP growth is above nominal interest rates and means that higher debt loads are now thought to be sustainable. This will be a relief for the increasing number of countries where debt is now above 100% of GDP.

Ultimately, debt will need to be addressed in one of four ways, or a combination of: higher taxation, reduced spending and austerity, inflation or default. Governments can delay this difficult choice until a later date.

**Figure 1: Real GDP forecast** (index, 4Q19 = 100)



Source: Oxford Economics, November 2020

Likewise, the European Central Bank is expected to increase the size of its asset purchase program in December while the Bank of England announced an additional GBP 150 billion of QE asset purchases at its November policy meeting.

Fiscal spending will also remain an important part of the macroeconomic picture during the current crisis. So far, the evidence from national fiscal plans is tilted towards a *green* recovery (e.g. France and the Netherlands) with the UK also emphasizing a *green revolution*. In the US, president-elect Biden is pushing for a USD 2 trillion climate change plan that will invest in infrastructure and clean energy across the transportation, electricity and building sectors. The plan promises to create millions of new jobs, and to build a more resilient and sustainable economy, while eliminating carbon emissions from the power grid by 2035. All these plans will potentially be a boon for the infrastructure sector.

However, there are still some political hurdles especially in the US. If Republicans retain control over the Senate (pending results from the January runoff elections), they will pose a challenge to Biden's ambitious green plans. The silver lining is that there has historically been more bipartisan support for clean energy than what the political headlines suggest. For example, red states such as Texas and Oklahoma actually have the highest amount of wind capacity in the US, while red states or swing states such as Texas and Florida make up a majority of the new solar capacity in the next five years. Ultimately, infrastructure spending is the tried-and-true way to alleviate unemployment and kick-start stagnant economies, and there is more urgency now to reach political consensus.

In Europe, beyond what each country is already doing at a local level, the European Commission's EUR 1 trillion European Green Deal will also drive new investments in green infrastructure. The EU's action plan is for Europe to be climate neutral by 2050 by investing across green energy, transportation, energy efficient buildings, and other environmentally friendly technologies.

The EU recognizes that the public sector cannot bear the entire burden of decarbonization. For example, European Commission President Ursula von der Leyen said that "... public finances alone will not be enough. We need to tap into private investment by putting green and sustainable financing at the heart of our investment chain and financial system." The EU will use a budget guarantee to allow the European Investment Bank (EIB) and other partners to invest in higher-risk projects while *crowding in* private investors.

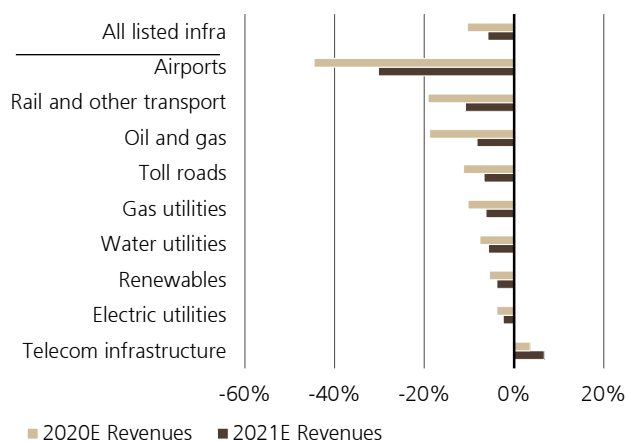
## State of the infrastructure market and outlook

The pandemic has impacted different infrastructure sectors to different degrees, with GDP-correlated assets such as airports, ports and toll roads most exposed to the ongoing economic shock. Social infrastructure, renewables and telecoms have seen less of an impact.

Public markets provide a rich source of real-time data to help inform our views for the private infrastructure industry. For example, if we look at the underlying revenue estimates of these publicly-listed infrastructure companies, it shows that analysts expect 2020 revenues for the broader sector to take a 10% hit (see Figure 2), with airports showing the most downside. On the other hand, telecommunication infrastructure revenues have actually been revised upwards, as the widespread lockdowns, working-from-home, remote learning, video streaming, e-commerce etc. have driven up the use of internet bandwidth.

Looking ahead at 2021, overall revenue estimates have only declined by 6%, with all sectors expected to perform better than they did in 2020. This is likely a result of the recent positive news on the coronavirus vaccines, which are expected to become more readily available to the general population by the middle of 2021. Regardless, telecommunication revenues will continue to see an additional boost next year.

**Figure 2: YTD change in 2020 and 2021 revenue estimates for listed infrastructure**













Source: Bloomberg, November 2020

A secondary impact of COVID-19 is its impact on global commodity markets. At one point, the oil price was down by more than 50% as oil is a key transportation fuel that saw a collapse in demand. Saudi Arabia's decision earlier in March to launch an oil price war further exacerbated this price volatility. Natural gas and electricity prices have also been impacted across various regions given pandemic-related lockdowns and the collapse in economic activity, although we have started to see some recovery of these commodities. In particular, natural gas prices are finding some support in the US, as the shutdown of oil wells actually halts the production of low-cost associated natural gas (a by-product of oil), which tightens the natural gas markets.

Table 1 sets out our outlook by sub-sector. While we expect the infrastructure sectors to improve versus 2020, certain sub-sectors have a more uncertain outlook and could remain significantly below 2019 levels.

**Table 1: Impact of COVID-19 on infrastructure sub-sectors**

	Sector	COVID Impact	2021 Outlook	Commentary & long-term outlook
Transportation	Airports		Negative	<ul style="list-style-type: none"> <li>– Traffic remains &gt;90% below 2019 in many affected regions</li> <li>– 2021 should see a rebound but likely to be well below 2019</li> <li>– Longer-term prospects closely interlinked with fate of vaccines</li> </ul>
	Toll roads		Stable	<ul style="list-style-type: none"> <li>– Passenger traffic recovered well after severe initial impact</li> <li>– Freight – which benefits from higher tolls – was resilient</li> <li>– Volumes will continue to be affected by restrictions, but sector showed strong rebound when conditions were eased</li> </ul>
	Ports		Stable	<ul style="list-style-type: none"> <li>– Container volumes at US and European ports recovered quickly</li> <li>– Ports exposed to Asia benefited from the region's recovery</li> </ul>
Energy and utilities	Oil & gas		Negative	<ul style="list-style-type: none"> <li>– Risk of underutilization, making some assets uneconomic</li> <li>– Cost of capital may be permanently reset higher</li> <li>– Natural gas outlook improves as associated gas volume declines</li> </ul>
	Renewables/energy transition		Positive	<ul style="list-style-type: none"> <li>– Low cost and long-term contracts offset power price risk</li> <li>– Policy support under the next round of fiscal stimulus, which will likely have <i>greener</i> characteristics</li> </ul>
	Power and utilities		Stable	<ul style="list-style-type: none"> <li>– Regulated utilities are well insulated, however, potential for rising bad debts</li> <li>– Conventional power and unregulated utilities more exposed to commodity price volatility</li> </ul>
Communications	Fiber		Positive	<ul style="list-style-type: none"> <li>– Fiber a big winner from this crisis. Increasing working from home creating requirement for a more distributed system</li> <li>– Strong political support for investment into rural fiber to close urban vs. rural divide</li> </ul>
	Data centers		Positive	<ul style="list-style-type: none"> <li>– Increased use of cloud applications and future proofing disaster recovery will be a positive for sector</li> </ul>
Social infrastructure	Public-private partnerships (PPPs/P3s)		Stable	<ul style="list-style-type: none"> <li>– PPPs benefit from availability-based revenues and therefore were well insulated. Healthcare assets are facing more operational challenges and may have to bear some increased costs</li> </ul>
	Non-PPP		Stable	<ul style="list-style-type: none"> <li>– Non-PPP assets are more of a mixed bag: assets serving the healthcare sector have seen an increase in demand but are dealing with higher operational costs of keeping their staff and patients safe and difficulties in attracting new residents</li> </ul>

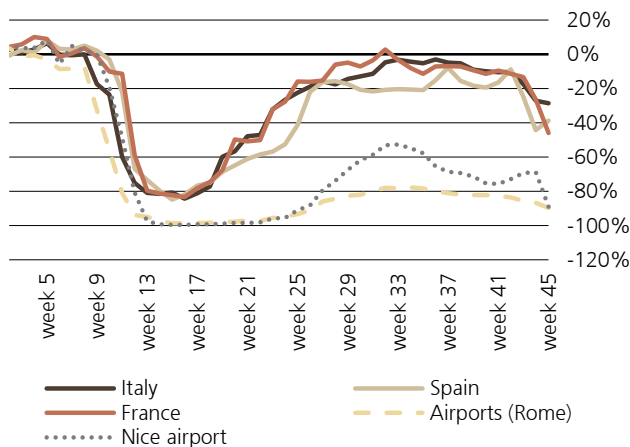
# Key sectors deep dive

## Airports

Airports are the sub-sector that has been hit hardest by the pandemic with passenger volumes still up to 90% below capacity in many affected regions. As shown in Figure 3, the easing of restrictions at the end of the summer in Europe provided only a temporary reprieve with volumes currently close to 1Q20 lows.

Within the sector we can observe some important trends: domestic and short-haul travel have recovered more quickly than long-haul; and cargo outperformed passenger traffic. For example, traffic at Heathrow airport from April to October was down by 85% for travel within the UK and Europe versus a 92% fall for non-EU traffic. Furthermore, cargo traffic in October was down by 23% versus 82% for passenger traffic.

**Figure 3: Airport recovery weaker than toll roads** (passenger volume change % YoY)



Source: Atlantia, November 2020

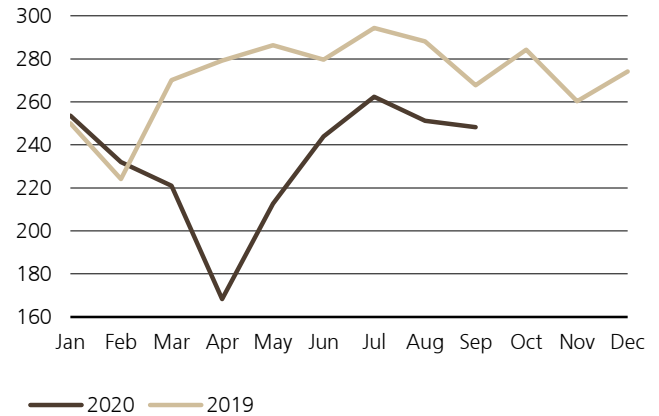
In the short-term, these asset features will continue to be relevant when looking at which airports are expected to outperform. Rapid testing, air bridges and shorter quarantining periods could also boost volumes. Longer-term, the outlook remains uncertain. The positive news around a vaccine could have a material impact on volumes. We would expect to see a rebound from pent-up demand once confidence returns. The International Air Transport Association's (IATA) latest forecast includes a 2021 vaccine in their base case. Under this scenario, they expect a strong bounce back in 2022 with a full recovery of 2019's volumes in 2023.

## Roads, rail and ports

Passenger volumes on roads have been much more resilient than air traffic (see Figure 3). While traffic initially fell sharply, volumes recovered quickly. In France, volumes had recovered fully before the most recent round of restrictions were introduced. We see a similar trend in the US (see Figure 4)

albeit levels are still below 2019. This difference is most likely due to more synchronized lockdowns in Europe versus a more state-by-state policy in the US.

**Figure 4: US total vehicle miles travelled** (billion)

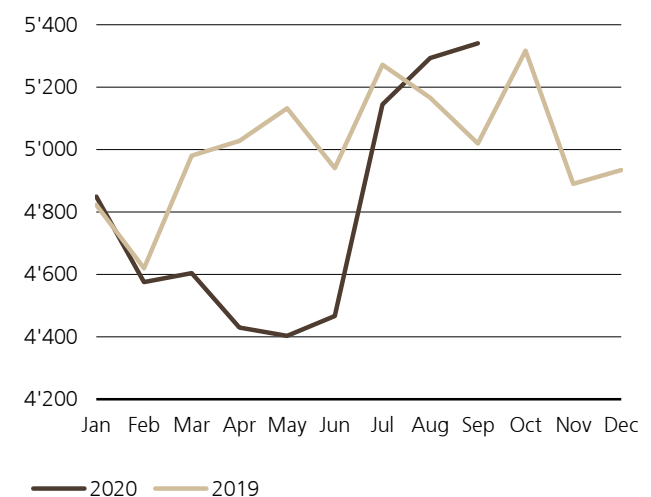


Source: U.S. Federal Highway Administration, November 2020

Across the transportation sector, freight transportation infrastructure has been the much more resilient than passenger transportation during the pandemic. Despite economic lockdowns and people staying at home, goods still need to be moved around the world, and so we have seen rapid recoveries across all means of freight transportation, including container port volumes, freight railings, and air cargo in certain regions.

Ports have been a particularly bright spot. For example, container volumes at US and EU ports have actually exceeded 2019 levels after some initial weakness earlier in the year (see Figure 5).

**Figure 5: Container volumes at EU and top 5 US ports** (000 TEUs)



Source: Bloomberg, November 2020. Note: Top 5 US ports include LA, Long Beach, NY/NJ, Savannah and Houston.

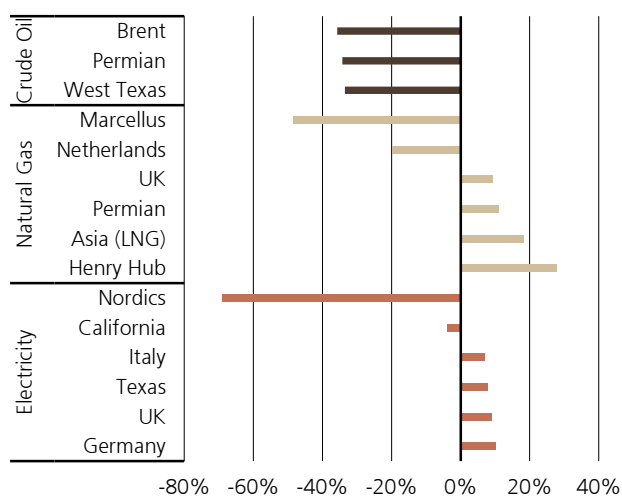
West Coast ports in the US have especially benefited from the recovery of container volumes from Asia, as countries in that region have handled the coronavirus pandemic relatively well, and have seen the least disruption in economic activity. In Europe, although the recovery has not been as rapid as in the US, European container volumes also recovered to 2019 levels by September, and are expected to improve further in 2021 once global economic activity recovers on the back of the distribution of vaccines.

### Oil and gas

The oil and gas sector has been under significant stress due to the dual threats of COVID-19 and the oil price war earlier this year (see Figure 6). Although Saudi Arabia has since reversed their decision and agreed to production cuts with Russia, oil prices never recovered to pre-COVID-19 levels, as transport fuel demand remains weak.

In addition, the negative oil price event in April further suggests that the potential volatility of the sector is greater than originally anticipated. Longer-term, even with an effective coronavirus vaccine and a global economic recovery, the cost of capital for the oil and gas sector may be permanently reset higher. Oil and gas infrastructure plays a particularly important role in the US, as the sector typically accounts for 20-30% of total private infrastructure investments each year. The recent price volatility has negatively impacted midstream infrastructure exposed to shale oil basins such as the Permian in Texas, which has been the most important growth driver of the oil and gas sector in the last few years.

**Figure 6: YTD change in commodity prices**  
(monthly average price)

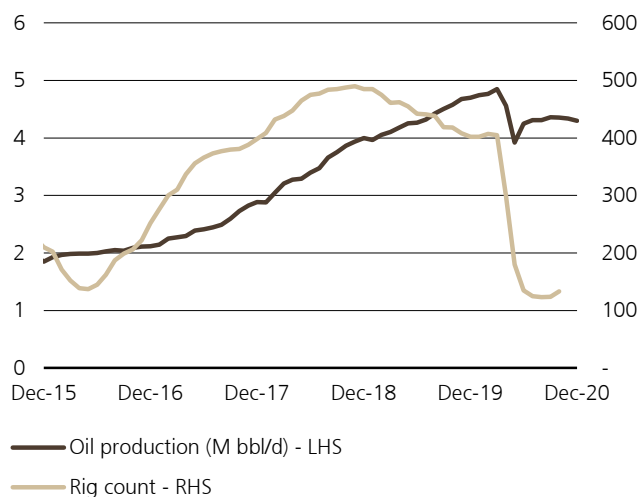


Source: Bloomberg, November 2020

The Permian Basin's rig count, which is a good proxy for the drilling activity in the area, has fallen by almost 70% since the end of 2019 (see Figure 7). Although oil production in the region has been holding up for now, there is usually a lag between drilling and production. This means there is

significant risk for production to further decline in 2021, thus impacting the throughput rates of oil and gas infrastructure in the area.

**Figure 7: Permian basin oil production and rig count**



Source: Bloomberg, November 2020

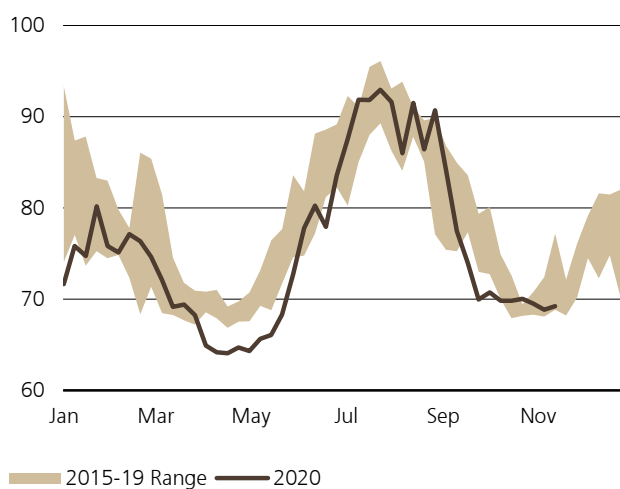
On the other hand, a decline in US shale oil production could be positive for midstream infrastructure exposed to pure-play shale gas basins such as the Marcellus. Low-cost associated gas, which is created as a by-product of oil, will no longer be available to flood the markets. This in turn means shale gas regions will have to step in to fill the supply gap left by the oil basins. Looking at commodity futures, markets actually expect US Henry Hub natural gas price to average USD 2.80/MMBtu in 2021, higher than the USD 2.57/MMBtu it averaged in 2019 before COVID-19.

Finally, the oil and gas sector may see more regulatory pressures under a Biden administration, especially with regards to emissions. However, regulation is not necessarily bad for everyone, as it also puts upward pressure on commodity prices and increases barriers-to-entry. This creates more differentiation between efficient and inefficient operators, good and bad assets, rich and poor shale geologies etc. This may not be positive for the industry as a whole, but it means that savvy investors could still find some good investment opportunities.

### Power and utilities

Economic lockdowns have impacted power demand around the world, although consumption is starting to recover as economies begin to open up. Despite the second COVID-19 wave, governments have been more targeted in their approaches to new lockdowns compared to earlier in the year. This means certain manufacturing activities and other electricity consumer heavy industries have been allowed to continue operating. Therefore, US and European electricity production and demand have almost returned to their historical average ranges (see Figure 8 and 9).

**Figure 8: US electricity production**  
(Electricity generation – TWh)



Source: Bloomberg, Edison Electric Institute, November 2020

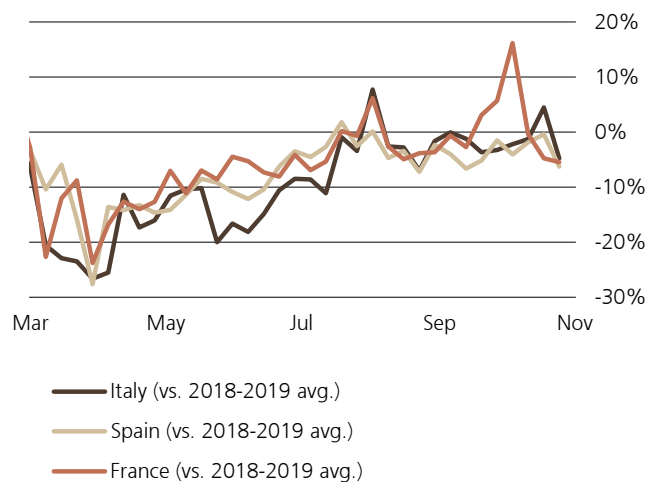
For power and utilities, although demand has been recovering, the actual financial impact will depend on whether a specific project has revenues secured through long-term contracts, or whether they have more merchant commodity price exposure. Although, as pointed out earlier in Figure 6, electricity prices have recovered for many regions since the beginning of the year. There are still some pockets of weakness, such as the Nordic region in Europe.

During the pandemic, renewable energy has attracted significant positive attention, given many of these projects have long-term power purchase agreements with high credit quality counterparties. Even for projects that do not have contracted revenues, their high margins and low costs still gave them downside protection even when prices were weak.

Looking ahead at 2021, interest in renewable energy will remain strong, as the sub-sector has proven its mettle during the pandemic. Project economics will continue to improve with cost declines and technological advances, while favorable policies will likely expand the opportunity set for investors. Conventional power generation will also recover as power demand returns to pre-COVID-19 levels, although the shutdown of US shale activity could drive natural gas costs higher, thus hurting less efficient gas-fired power generation.

For utility networks, regulated assets have been resilient to the volatility created by the pandemic, given their cash flows are protected by regulations or long-term contracts. This is evident in the revenue forecasts for utilities in Figure 2. However, utilities must watch out for the risk of increasing bad debts and regulatory risks, as unemployment and weak economic growth have impacted some customers' ability to pay their bills. The likely impact will depend on the level of fiscal stimulus and the speed of the economic recovery in 2021.

**Figure 9: European electricity demand almost back to historical levels** (YoY % change in weekly load)



Source: ENTSO-E, November 2020

Longer-term, the power and utilities sector will continue to see significant investments due to the ongoing energy transition. Policy tailwinds in the US and Europe will open up new doors and markets for investors, as well as new technologies. For example, mature technologies like offshore wind could finally start growing in the US under Biden, who can speed up new project approvals and open up federally controlled waters for new developments. Energy storage projects, which have already seen a significant increase in deal flows in the last few years, will continue to become more mainstream for infrastructure investments over time. Finally, hydrogen has gained a lot of attention this past year, especially since it was included in both the EU's Green Deal and Biden's USD 2 trillion climate change plan. Hydrogen is a carbon-free fuel alternative that can be used as transportation fuel for ships and trucks, or blended into existing natural gas networks, and could therefore become an important solution to decarbonization in the long-term.

**Telecoms**

The sector came into the pandemic with positive tailwinds around the exponential growth in data usage, fueling requirements for investment into fiber networks, data centers and mobile towers. In Europe, we saw widespread political support to rollout fiber (see Table 2) with many governments seeking to provide fiber to their entire population. The COVID-19 crisis has only accelerated these trends. The sector looks to be the real winner as large parts of the population continue to work from home and demand better connectivity.

**Table 2: Fiber connections growth plans**

European OECD countries	Rank 2025	ΔRank from 2020	Homes passed 2020 (millions)	2025 forecast (millions)	% Δ homes passed (2020-25)
UK	1	+3	8	19	238%
France	2	-1	18	6	33%
Italy	3	-	11	10	91%
Germany	4	+3	4	16	400%
Spain	5	-4	18	0	0%
Poland	6	-1	7	4	57%
Netherlands	7	-	4	3	75%
Sweden	8	-2	5	0	0%
Portugal	8	-1	4	1	25%

Source: IDATE, December 2018

In 2019, Microsoft estimated that 157 million Americans do not have access to broadband internet. In a recent poll by the Internet Innovation Alliance, 90% of respondents support Congress using federal funds to expand broadband internet network infrastructure to areas that currently do not have access, and 88% support Congress's increased support to those who cannot currently afford broadband internet, including students in low-income families. Therefore, the next wave of telecommunication infrastructure investments will need to address the current digital divide. Biden has already included affordable broadband services in his USD 2 trillion plan.

Infrastructure investors will accelerate the trend of investing into this sub-sector. We also expect strategics to continue rationalizing by selling non-core assets to capitalize on attractive valuations. As the next phase of opportunities emerge around 5G and managed data services, investors should continue to question the level of technology risk inherent in these investments and their appropriateness in core infrastructure portfolios.

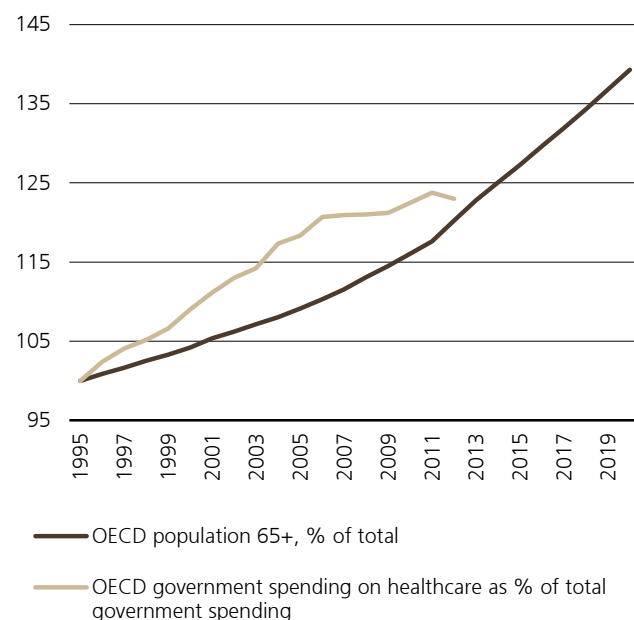
### Social

Infrastructure investors have a long track-record in investing into social infrastructure. The first wave of investments were structured as public-private partnerships (PPPs/P3), however, as this pipeline of opportunities dried up, managers looked for opportunities with less public funding, e.g. private hospitals, lab testing, care homes and student accommodation. The sector has been relatively resilient during this crisis although healthcare-related assets faced higher costs, particularly around keeping residents and staff safe. Within the care homes sector, assets operating within more regulated environments received some state support to deal with these increased costs, helping to mitigate the impact.

The challenges for this sector may potentially come in attracting new residents. More stringent regulation around the capacity of residents in facilities and concerns around families admitting family members into a sector that had been heavily hit by COVID-19 related deaths.

Public spending on healthcare and social care has not kept pace with the demands of an ageing population (see Figure 10). The COVID-19 crisis has put the spotlight on this lack of investment. We expect to see increased spending from the public sector into healthcare, but private capital will have a role to play as government finances will be increasingly stretched over the coming years.

**Figure 10: Health needs versus health provision**  
(Index 1995 = 100.0)



Notes: OECD average weighted by USD real GDP weighted at purchasing power parity; shaded area indicates forecast  
Sources: World Health Organisation, Oxford Economics, UBS Asset Management Real Estate & Private Markets, March 2018.

While the opportunity set in social infrastructure looks set to grow, the COVID-19 crisis provided a timely reminder of the reputational risks associated with investing into healthcare assets. Care homes were caught at the center of the outbreak in the first phase. In the UK, the Prime Minister highlighted failures by care home operators as contributing to high fatalities in the sector. This shows the importance of investing into quality assets and management teams in order to manage these complex operations successfully.



## Private infrastructure markets

In this section we look at the health of the infrastructure equity and debt markets in terms of fundraising, valuations and performance. In this year's outlook, we also take a closer look at the growing importance of sustainability and the increasing mandatory disclosure requirements placed on infrastructure investors.

### EU Sustainable Finance Disclosures Regulation (SFDR)

The EU's SFDR, which comes into place in 2021, has widespread implications for institutional investors and fund managers marketing in Europe. Investors that fall under the regulation will need to report their holdings under the sustainability-linked buckets: article 6 (integrates ESG); article 8 (promotes ESG); or article 9 (has a sustainable objective).

In order to receive these designations, products will need to make pre-contractual disclosures about how their strategies align and can be measured over time. While this will create an asset management burden for infrastructure investors, it also brings with it a significant opportunity. The SFDR recognizes that in order to achieve the climate goals under the Paris Agreement, the entire economy needs to be decarbonized, not just electricity. This requires new investment in clean transport and public services, energy storage, power-to-gas (e.g. hydrogen) and energy efficiency. Of the 70 key economic activities highlighted in the taxonomy guidance for sectors that could contribute to climate mitigation, the majority could be considered under the infrastructure umbrella.

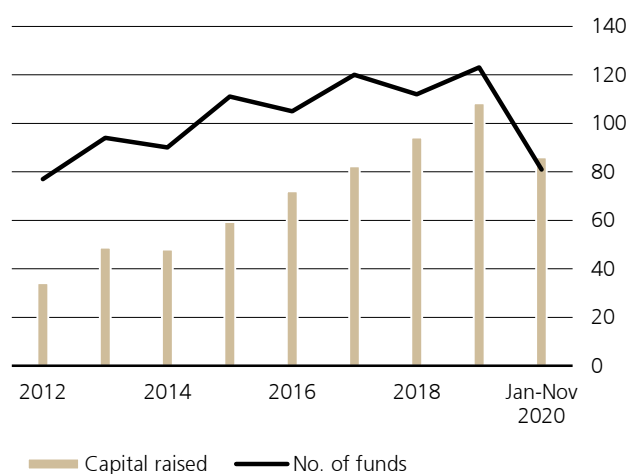
Public markets has been the main beneficiary of sustainability-focused investment: 2Q20 saw a record USD 54 billion<sup>1</sup> raised. We expect private markets to benefit from the wider demand for more sustainable investments, especially the infrastructure sector which has long being an investor into clean energy and transportation.

<sup>1</sup> MorningStar Direct, June 2020

### Infrastructure equity

Infrastructure fundraising has had a strong year with USD 86 billion of capital raised to date (versus USD 108 billion for the 2019 calendar year), see Figure 11. Given the tendency for large fourth quarter closes, 2020 could be another record year for the infrastructure industry. Sentiment towards the asset class is also strong according to Preqin, with 56% of institutional investors looking to increase their allocation in the coming year (vs. 39% for real estate).

Figure 11: Infrastructure fundraising trend (USD billion)

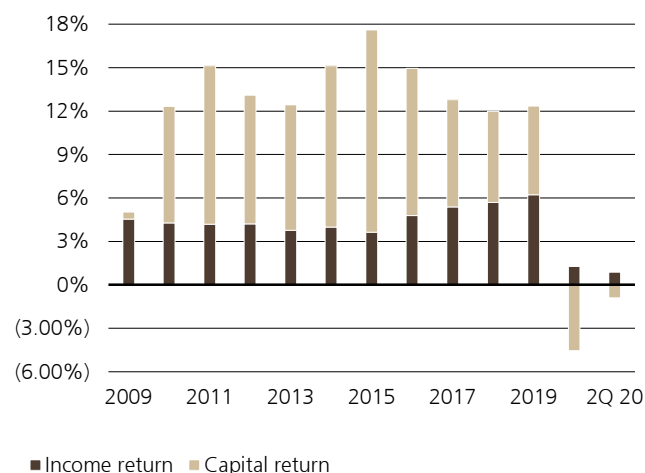


Source: Preqin, November 2020

Since March 2008, the infrastructure sector has delivered an annual return of close to 12% (income return of around 5% and capital of 7%), see Figure 12. The sector has been impacted by COVID-19, and reported returns were -3.3% in 1Q20 and flat in 2Q20. Within the infrastructure sector, the valuations for transportation assets were most affected with MSCI reporting -5% for this sub-sector in 1H20.

Figure 12: Infrastructure performance

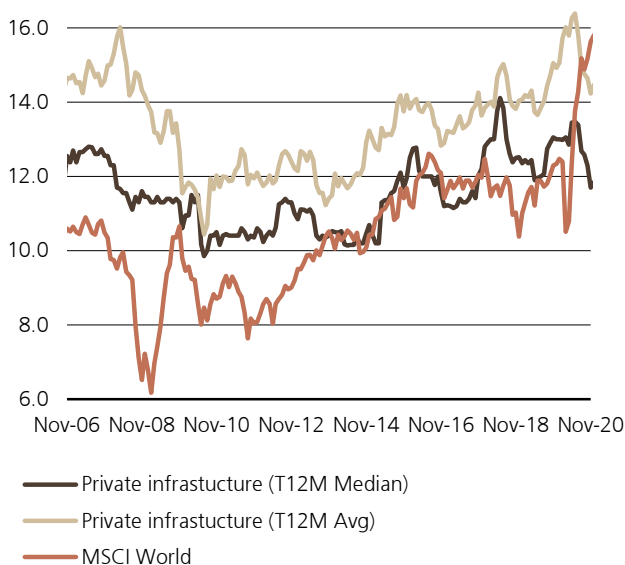
(Gross total return %, local currency)



Source: MSCI Global Quarterly Private Infrastructure Index, June 2020

We track the private infrastructure EV/EBITDA transaction multiples, and as we have seen in 2019, these multiples remain elevated (see Figure 13). However, 2020 has been a peculiar year for valuation multiples, as the steep decline in earnings have not been followed by an equal decline in overall valuations. Since the denominator has fallen more than the numerator, multiples based on 2020 earnings or even 2021 expected earnings received an artificial boost. This dynamic has played out in both the private and public markets.

**Figure 13: Private infrastructure EV/EBITDA multiples are elevated, although public markets have caught up**



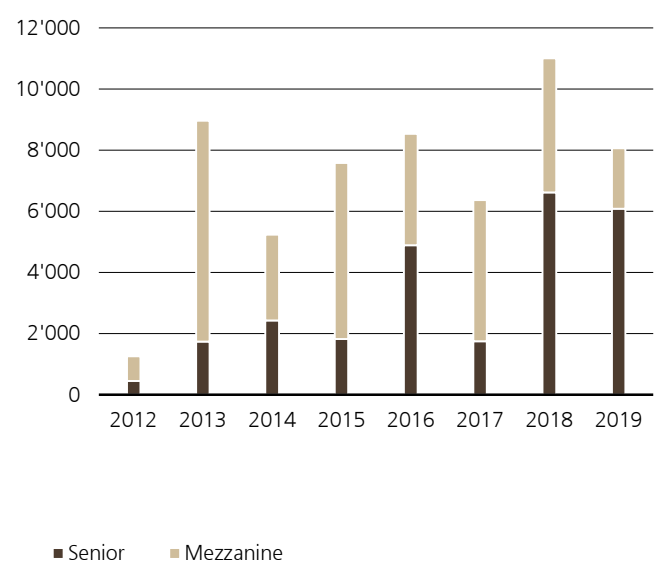
Source: UBS Asset Management Proprietary Database (based on 1,300 transactions); Mergermarket; InfraNews; Infrastructure Journal; Infrastructure investors; Bloomberg, November 2020

In addition, the private infrastructure markets have seen a large number of telecommunication transactions in 2020, which tends to skew private multiples upward given values are based on future rollout plans. According to Inframation, telecoms accounted for 20% of North American and European infrastructure deal volumes in 2020, vs. 8% in 2019 and 11% 2018. One of these telecommunication deals even fetched a valuation multiple of 133x, according to Inframation. If we look at the median rather than average multiples, private infrastructure valuations exhibit less volatility.

### Infrastructure debt

Senior and mezzanine infrastructure debt have experienced significant growth over the past decade (see Figure 14) and now form an important part of institutional investors' portfolios. The European market makes up around 90% of the senior funds raised over the past five years whereas North American-focused funds dominate the mezzanine market.

**Figure 14: Global infrastructure debt fundraising (USD million)**

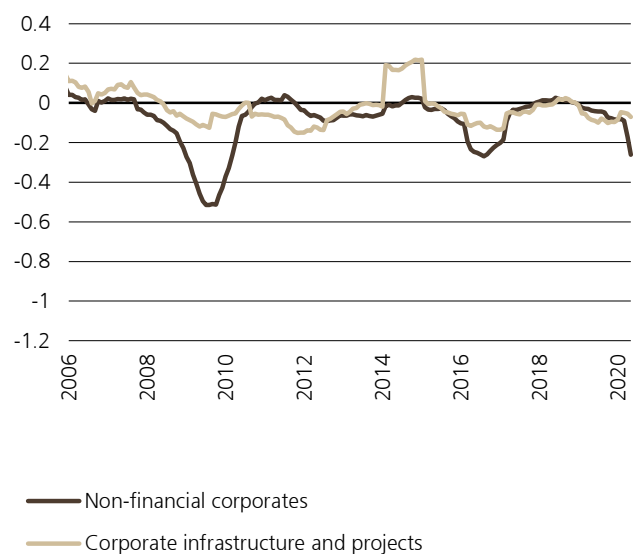


Source: Preqin, November 2020

Unlike corporates, infrastructure credits did not see a spike in defaults during the GFC, however, this crisis is different with certain assets being severely impacted. Notwithstanding this, private infrastructure valuations have held up well and showed more downside resilience versus real estate and private equity so far in this crisis<sup>1</sup>. This is consistent with the results from a study by Moody's (see Figure 15) that shows fewer coronavirus-driven infrastructure downgrades and defaults versus non-financial corporates. From March to May 2020, only two infrastructure issuers defaulted (0.1% of universe) vs. 66 non-financial corporates (1.3% of universe).

<sup>1</sup> Burgiss Manager Universe: 2Q20 Global Private Capital Returns

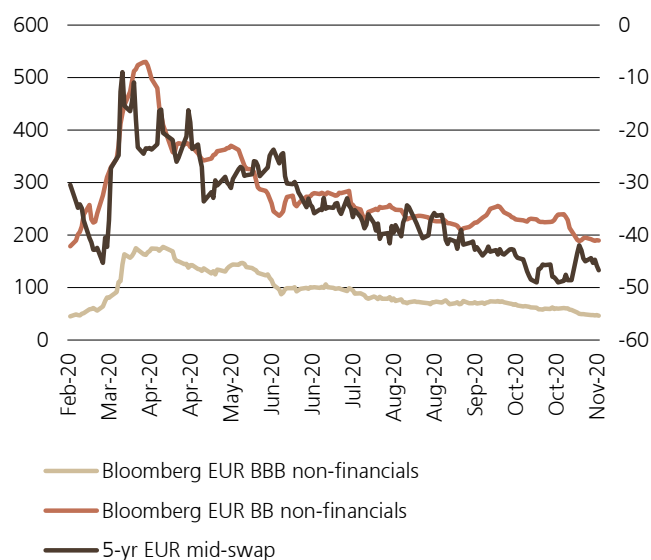
**Figure 15: Infrastructure downgrades vs. corporates**



Source: Moody's, Defaults & Recoveries: Fewer coronavirus driven downgrades than non-financial corporates, June 2020

Public fixed income spreads widened significantly during the early stage of the pandemic. As shown in Figure 16, this has now come back close to pre-COVID-19 levels with BBB and BB European non-financial corporates widening by around 15bps and 65bps, respectively, since February 2020. This is down from the peak stress point at the end of March 2020 of 150bps and 450bps, respectively, and reflects the unprecedented level of QE and fiscal stimulus programs. We've seen in the past that the ECB's asset purchases are effective in compressing spreads, and so, all else being equal, we would expect public spreads to continue to decline as the EUR 1.4 trillion program continues to flow through the system.

**Figure 16: European spreads (basis points p.a.)**



Source: Bloomberg, November 2020

Somewhat surprisingly, transaction volumes in Europe were up 8% in 1H20<sup>1</sup> (vs. 2019) although the number of transactions was down by 30%. While activity initially slowed down, it recovered from April as borrowers looked to use senior and mezzanine funding to bolster balance sheets, replenish liquidity or to restart capex plans.

## Conclusion

COVID-19 has accelerated the secular trends around decarbonization, digitalization and investments related to an aging population which will create a growing investment universe within the infrastructure sector. In Europe and the US there is an emphasis on re-building the economy to focus on a *green* future. The crisis has also highlighted deficiencies in broadband connection, heightening the urban-rural divide. In addition, COVID-19 has shown that government spending has not kept pace with the demands of an increasingly aging population. These will all need to be addressed as part of the recovery stimulus packages and this should lead to a boost for the infrastructure sector.

<sup>1</sup> PFI, 3Q20

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