Igneo Infrastructure Partners

Proactive asset management

Protecting portfolio performance in a rising interest rate environment

The evolution of the international debt capital and finance markets over the course of 2022 and 2023 has been well-documented, with both base rates and margins increasing to levels not seen since the global financial crisis of 2008–2009.

Economic indicators

Recent economic indicators suggest inflation may have peaked and is expected to gradually decline from the first half of 2023. Early gross domestic product data in 2023 is also projecting major economies (with the exception of the United Kingdom) to avoid recession.

The nature of unlisted infrastructure assets and the potential for proactive asset management strategies to mitigate these inherent risks provide an excellent opportunity for infrastructure managers to demonstrate the value they can add and the protection they can provide investors.

Capital markets pricings are reflecting expectations of central banks keeping their monetary policy relatively tight initially, but with a gentler pace of rates hiking toward their stated targets. A sudden worsening of the fragile geopolitical backdrop, however, could lead central banks to ease the rate of increases or even reduce rates in the longer term.

Bond markets are forecasted to continue experiencing some volatility in 2023, as borrowing costs remain elevated. Despite the current market environment, however, top-quality issuers are expected to continue to attract strong demand, as was demonstrated throughout 2022. This is especially true for core infrastructure issuers.

Bank funding costs have tightened, and wholesale funding markets have had a strong start to 2023. General sentiment from some banks that ended 2022 with concerns over the volume of funding costs appears to have eased.

The infrastructure debt market is expected to remain supportive but selective. Renewables and core infrastructure are expected to fare better on the back of government support and inflation protection. Pricing in the infrastructure finance market, however, is anticipated to continue to remain higher than the historically low rates witnessed for the past decade.

Demonstrating the value managers can add

All else being equal, higher base rates and higher margins should lead to negative valuation impacts on underlying asset values and, hence, investor returns. It is worth noting, however, that in reality other things are not held equal, and interest rates increase within the context of an inflationary macroeconomic environment that, in turn, leads to higher revenues. The net impact of this dynamic has been a demonstration of the protection that a diversified portfolio of core/core-plus infrastructure assets provides against inflation. The nature of unlisted infrastructure assets and the potential for proactive asset management strategies to mitigate these inherent risks provide an excellent opportunity for infrastructure managers to demonstrate the value they can add and the protection they can provide investors.

Sustainable long-term value comes from the relentless pursuit of operational excellence and the never-ending search for innovation and incremental improvement.

Alas, the same cannot be said for higher-risk asset classes and market segments, and unfortunately, anecdotal evidence from investors and industry colleagues suggests this has not been the case, and the rising interest rate environment has indeed negatively impacted asset valuations in these sectors.

Proactive and long-term outlook needed

This is further evidence, if ever needed, of the fundamental importance of a proactive and genuinely long-term outlook and approach when managing infrastructure businesses.

For example, applying this approach to cost-of-debt assumptions and using the centuries of historical data readily available allows a true long-term average cost of debt to be derived. Combining this with the implementation of long-term and fixed-rate debt financing within company capital structures insulates businesses against the short-term impacts of market movements and/or macro shocks. This, in turn, allows management to concentrate on the job at hand, which should be to become the best-in-class operators in their sectors.

Focus on 'real engineering,' not financial engineering

Sustainable long-term value comes from the relentless pursuit of operational excellence and the never-ending search for innovation and incremental improvement. In other words, good governance, long-term thinking and proactive management allow management teams to focus on real engineering and this, rather than financial engineering, is what creates real value and protects it over the long-term.

CONTRIBUTOR

Stephen O'Shea

Head of Investor Relations and Consultant Engagement

Igneo Infrastructure Partners

Based in London, Stephen O'Shea heads Investor Relations and Consultant Engagement for Igneo Infrastructure Partners. O'Shea currently sits on the board of directors of investee company Parkia. Prior to joining the team in 2008, O'Shea worked for ING.

This article presents the author's opinion reflecting current market conditions. It has been prepared for informational and educational purposes only and should not be considered as investment advice or as a recommendation of any particular security, strategy or investment product.

CORPORATE OVERVIEW

Igneo Infrastructure Partners is the direct infrastructure team of First Sentier Investors Group. Operating since 1994, the team works closely with portfolio companies to create long-term value through innovation and proactive asset management. Igneo manages $17.8 billion (as of March 31, 2023), on behalf of more than 200 institutional investors around the world.

CORPORATE CONTACT

Hillary Ripley, Business Development
Igneo Infrastructure Partners
hillary.ripley@igneoip.com | www.igneoip.com

igneo Infrastructure Partners