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Cohen & Steers Global Listed Infrastructure Strategy

The global infrastructure securities market, as represented by the FTSE Global Core Infrastructure 50/50 Net Tax Index, had a total return in U.S. dollars of 3.0% in the third quarter, bringing the year-to-date return to 16.4%.

Investment Review

Listed infrastructure continued to perform well in the third quarter, adding to strong year-to-date gains. Economic data generally exceeded expectations as the global economy expanded at its fastest pace in seven years, although momentum appeared to slow modestly in September.

Despite strong labor markets and improving consumer confidence, inflation remained subdued in the period. The 10-year U.S. Treasury yield was unchanged for the quarter at 2.3%, rising in mid-September after touching year-to-date lows on concerns over political tensions with North Korea and the potential effects of powerful hurricanes hitting the U.S. Central banks provided more clarity on interest rate policy and reducing the size of their balance sheets, but expectations remained for gradual credit tightening in the U.S. and Europe.

Most infrastructure sectors rose amid this constructive backdrop, with the more economically sensitive groups, including railways, toll roads and marine ports leading the advance.

Significant Private Investment Demand Supporting Valuations

Index Performance by Sector

Sector	Q3 2017	YTD 2017
Marine Ports	8.50 %	26.28 %
Airports	-2.44 %	26.09 %
Diversified	1.01 %	25.52 %
Toll Roads	5.23 %	22.43 %
Communications	0.90 %	21.25 %
Railways	4.74 %	18.58 %
Electric	1.55 %	9.78 %
Gas Distribution	-0.02 %	9.59 %
Water	2.68 %	9.12 %
Midstream	2.20 %	-0.04 %

Source: Cohen & Steers.

Data quoted represents past performance, which is no guarantee of future results. This information is not representative of any Cohen & Steers account and no such account will seek to replicate an index. You cannot invest directly in an index and index performance does not reflect the deduction of any fees, expenses or taxes.

Demand for infrastructure investments remained high in the quarter. The latest data from market intelligence provider Preqin showed that a record $158 billion of uninvested private capital targeting infrastructure assets is waiting to be deployed, up from $109 billion at the end of 2015. While several deals have been announced this year across many infrastructure subsectors, considerable capital remains on the sidelines given the limited number of investable infrastructure assets that are sold at any particular point in time.

In general, private investors have paid significant premiums for assets—well above the current market-implied cash flow multiples of listed infrastructure companies, based on our estimates. We believe this massive—and increasing—backlog of private capital may continue to provide a rising valuation floor across the listed infrastructure universe, warranting the premium valuations of the asset class relative to its history and relative to the broader equity market. Listed infrastructure may also see increased demand considering that, unlike in the private market, investors can implement an allocation to it immediately.

Potential Impact from U.S. Tax Reform

President Trump's tax proposal, unveiled in late September, included a call for overall simplification of the tax code, lower corporate and personal rates and an incentive for firms to repatriate overseas profits. While merely an outline at the moment, we see the proposal as neutral at worst for U.S. infrastructure companies and potentially highly beneficial for some.

Our initial assessment is that freight rails would likely see the greatest immediate financial benefit, as they are the infrastructure subsector with the highest effective tax rate. Also, to the extent a reduction in the corporate tax rate spurred on economic growth, freight traffic could increase.

Regulated utilities with large, profitable non-regulated businesses might also see some benefit from tax reform. However, the regulated portion of utilities' operations would probably not enjoy a lasting gain, in our view, as any initial benefit from a reduced tax rate would likely be passed on to customers in future rate cases.

Midstream energy sector entities structured as corporations might also benefit from lower taxes, like any other companies subject to taxation. However, midstream companies structured as master limited partnerships, which are pass-through vehicles and do not pay corporate taxes, could be potentially less "advantageous" relative to traditional corporations.

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Sector Highlights

- Marine ports (8.5% total return in the index[1]), toll roads (5.2%) and railways (4.7%)—generally the more economically sensitive infrastructure sectors—responded favorably to the synchronized global growth seen in the quarter. Toll roads also rose on expectations in Europe of consolidation in the sector following Atlantia's $17.8 billion bid for Abertis Infraestructuras, which would create the region's largest toll road company.
- Towers (3.4%) experienced additional momentum on favorable growth prospects stemming from continued increasing data demand.
- The midstream energy sector (2.2%) rebounded following weakness in the first half of the year, as crude oil prices climbed to a two-year high amid stronger demand and falling inventories.
- Electric utilities (1.6%) underperformed as expectations for interest-rate increases weighed on U.S. utility stocks late in the quarter.
- Airports (–2.4%) lagged following a strong first half, despite strong year-over-year passenger volume growth in the quarter. Companies in emerging markets generally advanced, although Mexican airports declined as NAFTA renegotiation talks got underway.

Portfolio Performance

The portfolio advanced in the quarter but lagged its benchmark. Stock selection and an underweight in toll roads detracted from relative performance. The portfolio was overweight Ferrovial, which declined on weaker expectations for its peripheral businesses—despite its core assets continuing to perform well. Also, we did not own Atlantia or Abertis Infraestructuras. We believe the proposed merger between the two does not offer great synergies and expect Atlantia's multiples to contract, as the company is paying a premium for a less attractive set of assets than it currently operates, with shorter-term concession durations.

Stock selection in railways also detracted. The portfolio held overweight positions in two Japanese passenger rail companies that modestly declined in the period as the stronger yen appeared to dampen expectations for foreign tourism in the country. We were underweight Rumo, a thinly traded Brazilian freight operator that rose sharply on little news and Norfolk Southern, which rose after reporting favorable quarterly results. The portfolio's underweight in marine ports further hindered relative performance. Despite healthy growth worldwide, we believe the sector remains vulnerable to soft global trade conditions.

The portfolio's stock selection in communications was an important contributor to relative performance during the quarter. In towers, we particularly benefited from Infrastrutture Wireless Italiane, which rose sharply on expectations of European growth. We did not own companies in the satellites and telecommunications sectors, both of which declined amid increasing competition.

Stock selection and an underweight in airports also contributed to relative performance. The portfolio benefited from an out-of-index position in Airports of Thailand, which despite concerns of a slowdown, saw continued strong passenger volume gains. In addition, we did not own AENA, which declined following strong first-half returns. Stock selection in midstream energy also contributed. This included an overweight in Pembina Pipeline, which continued to progress in its merger with Veresen. We held an out-of-benchmark position in Kinder Morgan Canada, which rose on expectations that the company would move forward with its Trans-Mountain pipeline expansion.

Investment Outlook

Global growth in recent months has been stronger than we had anticipated several months ago. With less impulse from the inventory cycle and financial conditions, the global economy could weaken slightly in 2018. We remain particularly constructive toward continental Europe, where strengthening labor market conditions are bolstering consumer confidence. We are somewhat more cautious toward the U.S., as it stands at a later stage in the economic and monetary cycles than other markets. We look for interest rates to climb gradually in developed markets worldwide in response to decent economic growth, reduced monetary stimulus, and in light of modestly rising inflation.

U.S. water utilities offer the potential for accelerating growth. We believe critical pipeline replacement projects across the U.S. should drive significant growth for water utilities, with the consolidation of the largely municipally owned sector a further tailwind. U.K. water utilities have underperformed, in our view pricing in the risk inherent in the upcoming regulatory rate review process.

Secular tailwinds for towers. U.S. and European tower owners, in our view, are well-positioned to benefit from strong long-term secular demand growth for wireless data services and the adoption of 5G, small cells and other technologies to handle the increasing data usage. We believe the sector's valuations remain attractive relative to our growth expectations.

Railways' strong long-term outlook but near-term challenges. The outlook for freight railways in 2018 and beyond continues

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to be offset by challenging upcoming year-over-year volume comparisons and recent pricing trends for the industry. U.S. freight rails may also gain if proposed corporate tax cuts are enacted, while better economic conditions should continue to boost passenger railways.

Midstream energy sector in transition. The growth in North American energy production volumes is driving a positive shift in the fundamental cycle for midstream energy companies, translating into improving cash flows, which we believe will eventually lead to a reacceleration of distribution growth. In the meantime, however, conditions remain challenging, as most basins are materially oversupplied with energy infrastructure and competition is likely to increase.

Airports outlook encouraging, but sector remains expensive. Despite their strong fundamentals, we remain wary of airports, particularly in Europe, where year-over-year volume comparisons are likely to become more difficult and may lead to some underperformance.

Electric utilities at risk from rising rates. We generally maintain a cautious stance toward U.S. electric utilities, due to their modest growth prospects, company-specific regulatory issues and vulnerability to rising interest rates.

(1) All sector returns in this commentary are in local currencies. Sector classification of securities in the index is determined by the investment advisor.

Data quoted represents past performance, which is no guarantee of future results.

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

The Macquarie Global Infrastructure Index, calculated and managed by FTSE, is designed to reflect the stock performance of infrastructure companies, principally those engaged in the management, ownership and/or operation of infrastructure and utility assets.

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

The FTSE Global Core Infrastructure 50/50 Net Tax Index is a market-capitalization-weighted index of worldwide infrastructure and infrastructure-related securities and is net of dividend withholding taxes. Constituent weights are adjusted semi-annually according to three broad industry sectors: 50% utilities, 30% transportation, and a 20% mix of other sectors, including pipelines, satellites, and telecommunication towers.

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