Aquila Capital

AT A GLANCE – INFRASTRUCTURE INVESTMENTS

REALIZING ADVANTAGES THROUGH MULTI-MANAGER SOLUTIONS NR. 2

Behaviour in the event of market fluctuations

The current crisis has led to considerable distortions on the financial markets. While the announcement of enormous economic stimulus packages by governments around the world provided a partial recovery, the final economic effects of the corona pandemic are not yet foreseeable. In particular, volatility on the stock markets returned after a prolonged bull market.

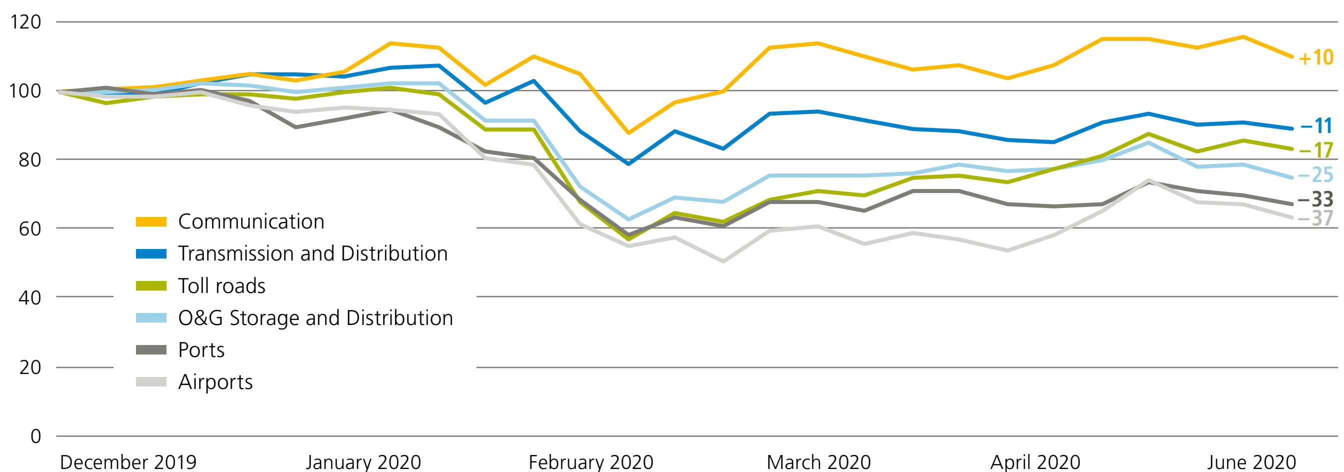
Impact of the pandemic on various sectors of infrastructure

A look at the infrastructure sectors shows that they are affected very differently. In particular, the focus is on the respective remuneration structure. The market for alternative infrastructure investments, i.e. unlisted investments, is not transparent due to the lack of publicly available data. For this reason, indices of listed infrastructure companies are used as a guide to the development of the individual infrastructure sectors. In the next chapter, however, the differences to unlisted investments that need to be taken into account are discussed.

The figure shows the performance of listed infrastructure companies based on their quotation at the end of 2019.

In line with expectations, the telecommunications industry is emerging as the winner of the crisis. After a 10% loss compared to the previous year's close at the beginning of the lockdown restrictions, home-office-solutions and the enormous expansion of digital media gave a boost to stocks in this segment. The telecommunications industry is the only sector to show a positive development in the comparison considered here.

Performance of listed infrastructure companies by sector in the first half of 2020[1]



It is followed in second place by the network operators and utility sector. Despite the provision-dependent and government-regulated fee structure, the index shows a decline of more than 10% compared to the end of 2019. Irrespective of the fundamental resistance to the crisis, the cyclical nature of the stock markets is clearly evident. Listed infrastructure companies show a high correlation to the stock markets and panic on the stock exchanges leads almost immediately and across sectors to significant losses.

However, the demand-dependent sectors in particular, which generally have highly cyclical compensation, have suffered significant losses. Restrictions to contain the virus, such as curfews or school closures, significantly intensified these effects. As a result, share prices of infrastructure companies in the transport sector recorded slumps of up to 40% and more. Whilst the easing of restrictions led to a slight recovery, uncertainty remains at a high level. The long-term consequences are not yet foreseeable.

[1] *Aquila Capital, own calculation, based on Bloomberg data*

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The lockdown also had a strong impact on the energy sector. Amplified by politically induced increases in supply (oil price war, gas transit) and mild weather conditions in winter, the global slump in demand led to significant price declines for oil and gas. In the USA, the price even fell into negative range due to storage facilities being too scarce. As a result of significant price declines in raw materials and a demand shock, electricity prices also fell to very low levels, placing a significant burden on power plant operators. In the renewable energy sector, however, state subsidies on the one hand and the PPAs on the other cushioned the impact considerably. Moreover, a recovery already emerging in electricity price futures is keeping expectations very optimistic.

In part, the crisis should have had a positive impact on companies focusing on social infrastructure. The provision-dependent remuneration of government agencies and the central importance that hospitals, for example, play in the crisis ensure a high degree of resilience of these infrastructure facilities in the crisis.

Unlisted infrastructure investments benefit from low correlation with other asset classes

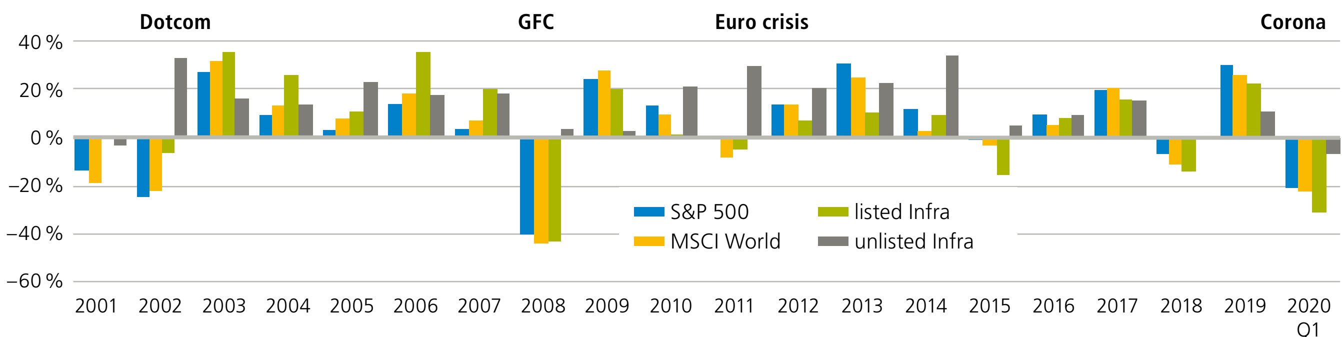
Compared to listed infrastructure companies, non-listed infrastructure companies – based on often contractually fixed cash flows – have a significantly higher resistance to crises. Furthermore, they are not exposed to the high volatility created by market players on the stock exchange.

The graph shows the development of the asset classes over the past 20 years, in which four major crises have been experienced. In line with the low correlation to other asset classes, it becomes clear that unlisted infrastructure investments were not subject to fluctuations comparable to those of the equity markets during the crises. A marginal decline was recorded after the bursting of the "dotcom bubble". In contrast to the distortions on the stock market, however, this loss was more than compensated for in the following year. While the global financial crisis and the subsequent euro crisis did not lead to any losses, the most serious crisis of the still young millennium saw a comparatively small decline of only 6.3%. Significant effects on the demand-dependent sectors are decisive.

Due to the low correlation to other asset classes, non-listed infrastructure investments have a high potential to improve portfolio diversification. In contrast to listed infrastructure companies, however, the segment is characterised by high barriers to market entry due to the volumes and minimum capital requirements. As a diversified strategy is also essential within the segment, it is challenging for many investors to build up infrastructure investments. However, institutional investors with a long-term investment horizon, in particular, could benefit greatly from the advantages. The selection of managers and access to opportunities also represent a high hurdle.

Multi-manager approaches can help here.

Comparison of asset class behaviour[2]



[2] *Bloomberg (2020)*

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