Insight INVESTMENT

INFRASTRUCTURE IN A MULTI-ASSET STRATEGY

FEBRUARY 2022

BNY MELLON | INVESTMENT MANAGEMENT

EXECUTIVE SUMMARY

- The listed infrastructure market is growing rapidly in size, with new companies helping to finance a societal shift in infrastructure demand.
- We believe this evolution is creating assets that fit well within a multi-asset strategy, particularly as they are more resilient to changes in the economic cycle. We have been shifting the composition of our holdings to take advantage of this opportunity.
- Given a focus on social and environmentally supportive infrastructure, many of these assets are of natural interest to investors seeking to invest responsibly, but engagement is key to ensure that their ESG goals are being carried through.
- Infrastructure has been a core element of our multi-asset strategy for many years. Our focus has been on less economically sensitive parts of the infrastructure universe – concentrating on assets that produce stable long-term cashflows, often linked to inflation, that can have a low beta to global equities.

A LARGER, DEEPER MARKET PROVIDING A BROADER OPPORTUNITY SET

With investors increasingly looking for real assets and stable cash flows, the listed infrastructure sector has grown rapidly. While providing global exposure, the regulatory framework and investor demand has led the UK market to be an attractive hub and focal point for listing of closed ended investment companies. By the end of 2021 there were over 30 listed infrastructure companies (see Figure 1) with a total market capitalisation of over A$50bn.

Figure 1: The number of listed closed-end infrastructure companies has trended higher

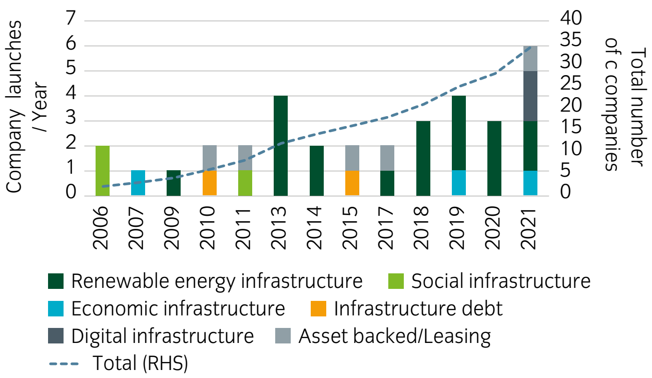
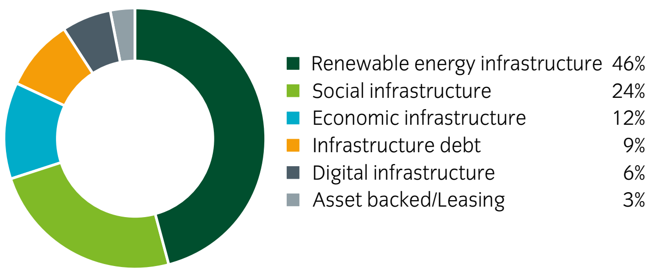


Figure 2: As more companies launch, so the market opportunity set has diversified



SOCIETAL SHIFTS ARE CREATING NEW OPPORTUNITIES

Many newer companies are seeking to finance projects which are being driven by a societal shift in infrastructure demand. Renewable energy has grown to become a significant part of the sector – initially financing projects such as windfarms and solar power, but evolving to encompass projects such as anaerobic digestion, which use bacteria to turn biomass into energy, battery storage, or that seek to monetise energy efficiency gains. A more recent innovation is accessing digital infrastructure, financing subsea fibre cables and wireless networks to improve access to communication services. The market has expanded from being primarily UK focused, to include projects across Europe and more recently the US.

[1] Source: Insight and Bloomberg. Data as at 28 January 2022. [2] Source: Insight and Bloomberg. Data as at 28 January 2022. Encompasses all fully UK listed closed end investment companies in the infrastructure sector.

ASSESSING THE ECONOMIC SENSITIVITY OF INFRASTRUCTURE INVESTMENTS

Historically, infrastructure investments have been broadly categorised as either social or economic in nature; we outline the types of characteristic we would expect within these categories below:

SOCIAL INFRASTRUCTURE

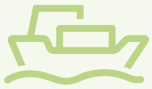
- Provides essential services for society (e.g. provision of education, health care, transport, social housing and other assets required for public services)
- Procured and funded through long-term concessions programs (e.g. private finance initiative (PFI), public private partnership (PPP) and other government programmes)
- Concessions provide availability-based revenue streams with some inflation linkage
- Yield likely to be the main component of total returns
- Key risks around ensuring availability of assets, management of costs, and retrospective changes to regulation

ECONOMIC INFRASTRUCTURE

- Supports economic development and enables movement of people, goods and information (e.g. regulated utilities, communication infrastructure, renewable energy, transportation and transmission assets)
- Funded through long-term concessions, private sector investment and end-user payments
- Higher potential for capital appreciation
- Key risks include pricing, demand/volume, and regulatory changes. Political, social, economic and environmental risks additionally bear on renewable energy infrastructure

Economic sensitives within the traditional infrastructure universe (shown in Figure 3) tend to be greater for economic infrastructure than for social infrastructure.

Figure 3: Economic sensitivities of infrastructure investments[3]

Risk class	Availability	Regulatory	Demand based	Market
Investment risks are incremental	Operating costs Delivery (e.g. service performance)	+ Regulatory risk + Volume risk (low)	+ Volume risk (high) + Known pricing risk	+ Competitive risks
Examples				
	Hospitals, schools, government accommodation Availability transport (e.g. road/rail)	Energy distribution, transmission, storage Water, waste water Renewable energy (off-take or feed-in)	Real toll roads, tunnels, bridges Light, heavy rail Airports / Marine ports Digital	Merchant power (no off-take) Ferries Service stations Waste
	Lowest risk segment ('public assets')	**Resilient to economic cycle**	**Exposed to economic cycle**	**Private equity style exposure**
	Social infrastructure		**Economic infrastructure**	

[3] Source: For illustrative purposes only.

INFRASTRUCTURE IS A CORE PART OF OUR STRATEGY

Infrastructure has been a core element of our multi-asset strategy for many years. Our focus has been on less economically sensitive parts of the infrastructure universe – concentrating on assets that produce stable long-term cashflows, often linked to inflation, that can have a low beta to global equities.

As can be shown in Figure 4, to deliver our return objectives in a smooth manner, we operate a dynamic approach to asset allocation. We have significantly changed our exposures over time as we adapt our cyclical positioning to the market outlook, but we have maintained our exposure to infrastructure within a tight range. This stems from our belief that our carefully selected holdings should provide both stable long-term returns and diversification benefits through a variety of market conditions.

Figure 4: A history of our dynamic asset allocation over recent cycles[4]

	Cyclical upswing		Volatility and divergent growth			Policy hope versus economic fragility		Covid growth shock and volatility versus stimulus				Vaccines and economic recovery			
	2016	2017	2018			2019		2020				2021			
	Dec	Dec	Mar	Sep	Dec	Jun	Dec	Feb	Mar	Jun	Sep	Dec	Mar	Jun	Dec
Fixed income	**33**	**36**	**34**	**43**	**47**	**46**	**37**	**38**	**44**	**55**	**50**	**39**	**30**	**31**	**33**
Government bonds	10	14	12	17	22	22	14	21	26	20	13	11	11	13	23
Investment grade	11	10	9	16	14	9	10	7	14	21	20	10	2	0	0
High yield	6	4	4	4	4	6	6	4	2	8	9	9	12	12	8
Emerging market bonds	5	8	9	6	7	9	9	6	3	6	8	9	5	5	2
Equity	**38**	**41**	**21**	**24**	**12**	**29**	**37**	**15**	**5**	**20**	**20**	**34**	**38**	**42**	**35**
Real assets	**12**	**12**	**12**	**12**	**10**	**11**	**10**	**10**	**6**	**8**	**10**	**12**	**14**	**16**	**16**
Commodities	3	2	3	2	1	1	2	1	0	0	2	3	4	7	6
Infrastructure	**9**	**8**	**7**	**8**	**7**	**8**	**8**	**9**	**6**	**8**	**8**	**9**	**10**	**9**	**10**
Total return strategies	**12**	**4**	**15**	**15**	**14**	**8**	**11**	**13**	**9**	**10**	**12**	**11**	**10**	**9**	**9**
[Total return strategies (gross)]	**[108]**	**[71]**	[112]	[124]	[69]	[100]	[97]	[136]	[92]	[77]	[87]	[109]	[77]	[62]	[59]
Net cash	**6**	**8**	**17**	**6**	**17**	**6**	**5**	**25**	**36**	**7**	**7**	**4**	**9**	**3**	**7**
Total strategy	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

[4] Source: Insight. As at 31 December 2021. Please refer to the risk disclosures at the back of this document. As at 31 December 2021. Data is given for a representative portfolio that adheres to the same investment approach as Insight's broad opportunities strategy. Positions are shown on a net basis with an additional line showing gross exposure for Total Return Strategies in brackets. Net exposure sums to 100%. Cash: Includes cash at bank, FX forwards and money market instruments. Please note that the total allocation may not total 100.0% due to rounding.

WE BELIEVE THIS EVOLUTION IS CREATING ASSETS THAT FIT WELL WITHIN A MULTI-ASSET STRATEGY

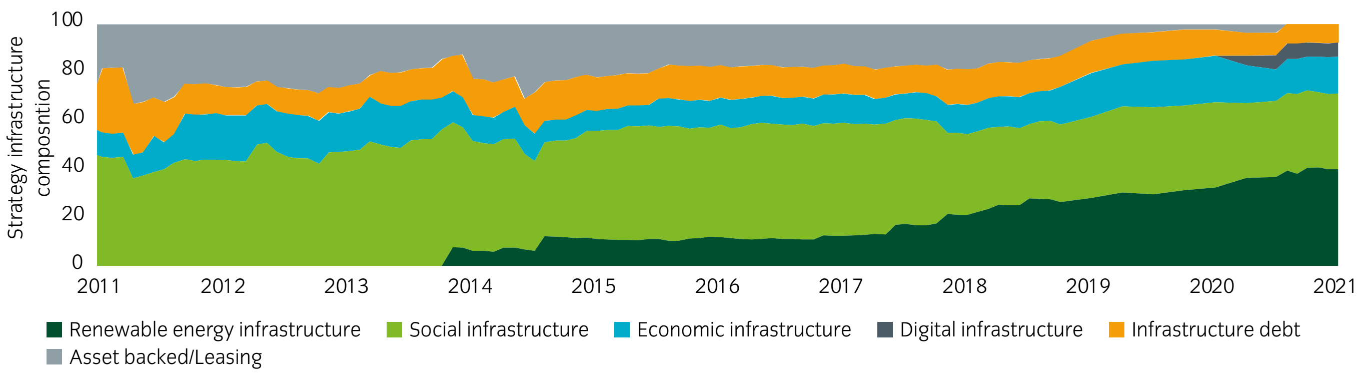
A key benefit to the way the market has evolved is that growth has primarily been in sectors that are more resilient to changes in the economic cycle. This differs to more economically sensitive infrastructure assets such as airports, where revenues can be more variable depending on economic activity. We outline this in Box 1.

When we search for infrastructure holdings that are suitable as part of a broader multi-asset strategy, we believe that the following sectors best fit the requirements of multi-asset investors:

- ✓ **Renewable energy**, which is a rapidly growing sector that is at the more resilient end of the economic sensitivity spectrum. Within this, we would regard renewable energy assets with a high degree of contractual subsidy as having a lower sensitivity to the economic cycle. Bloomberg estimates that an additional 13.3 trillion US dollars of investment will be needed by 2050 to expand existing energy capacity, with 77% of this investment expected to go into renewables, which should present continued investment opportunities over time.
- ✓ **Social infrastructure** including investments that promote social development and quality of life and seek to have a positive impact on communities.
- ✓ **Economic infrastructure** that is resilient to the economic cycle (e.g. regulated water utilities, electricity distribution networks and digital infrastructure assets) and which we believe over time will benefit from more stable revenue streams.
- ✓ **Infrastructure debt**, linked to investments in social, renewable and economic infrastructure investments.

As more of these opportunities have become available, so we have shifted the composition of our infrastructure holdings over time, seeking stable returns and lower susceptibility to economic cycles across a diversified basket of companies.

Figure 5: Our infrastructure exposure over time[5]



[5] Source: Insight and Bloomberg. Data as at 31 December 2021.

ENGAGEMENT IS IMPORTANT TO ENSURE ESG GOALS ARE BEING MET

We ensure that all of our infrastructure holdings, or their underlying investment manager, are signatories to the UN Principles for Responsible Investment (PRI), all of them have sustainable investment strategies and many have key performance indicators that are explicitly linked to sustainability goals. However, we believe that active engagement also plays an important role to ensure that companies remain on track and progress. As part of Insight's approach to stewardship we require that a proprietary ESG questionnaire is completed, providing detailed answers on issues not covered within standard publications. Where we identify issues, or events justify it, this helps focus our research and engagement when meeting with the appropriate representatives of the company to discuss.

Over time, this engagement can often encourage greater transparency within official reporting, as companies gain a better understanding of the information their investors are seeking

RECENT EXAMPLES OF ENGAGEMENT

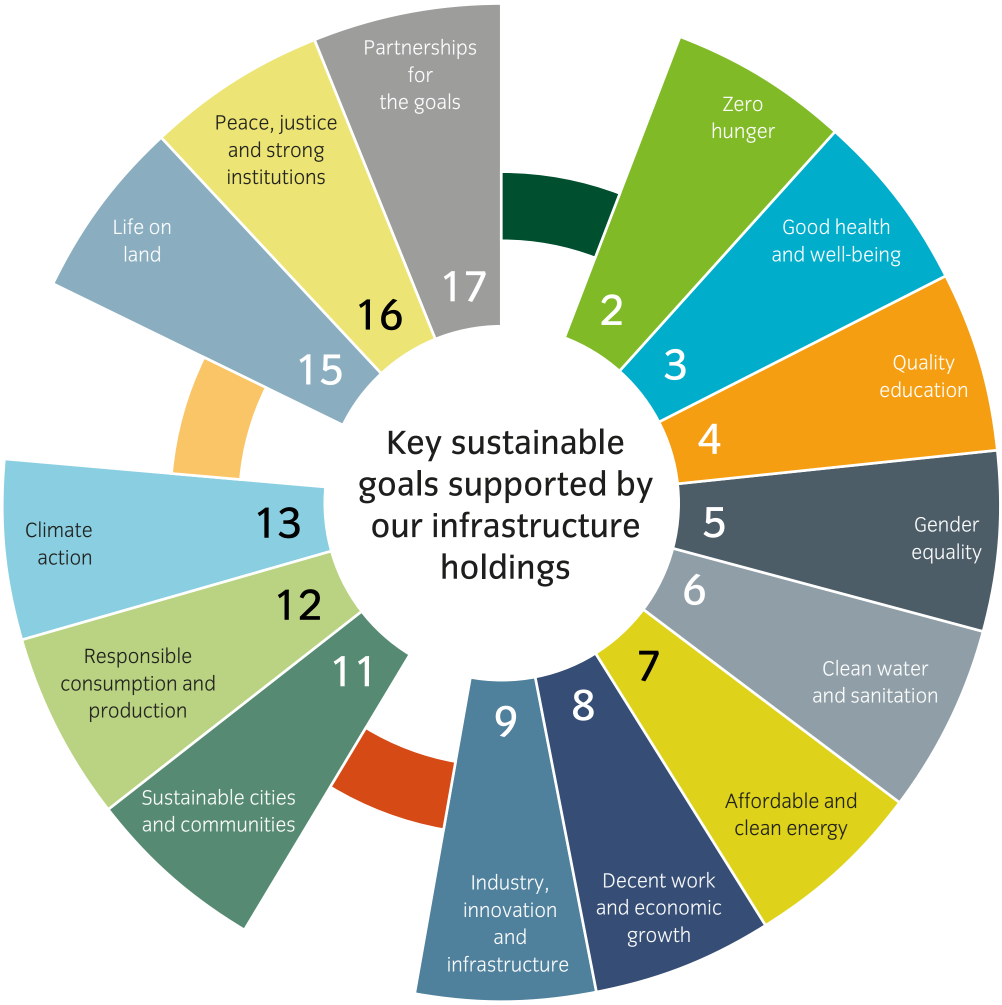
- ✓ Review of health and safety practices across our renewable energy holdings after an incident
- ✓ Engaging with the board of one holding regarding their low dividend coverage
- ✓ Engagement with investment managers regarding personnel changes, net zero targets and enhanced ESG reporting
- ✓ Engaging with the Foreign, Commonwealth and Development Office on MOBILIST[6] programme to address the sustainable development financing gap

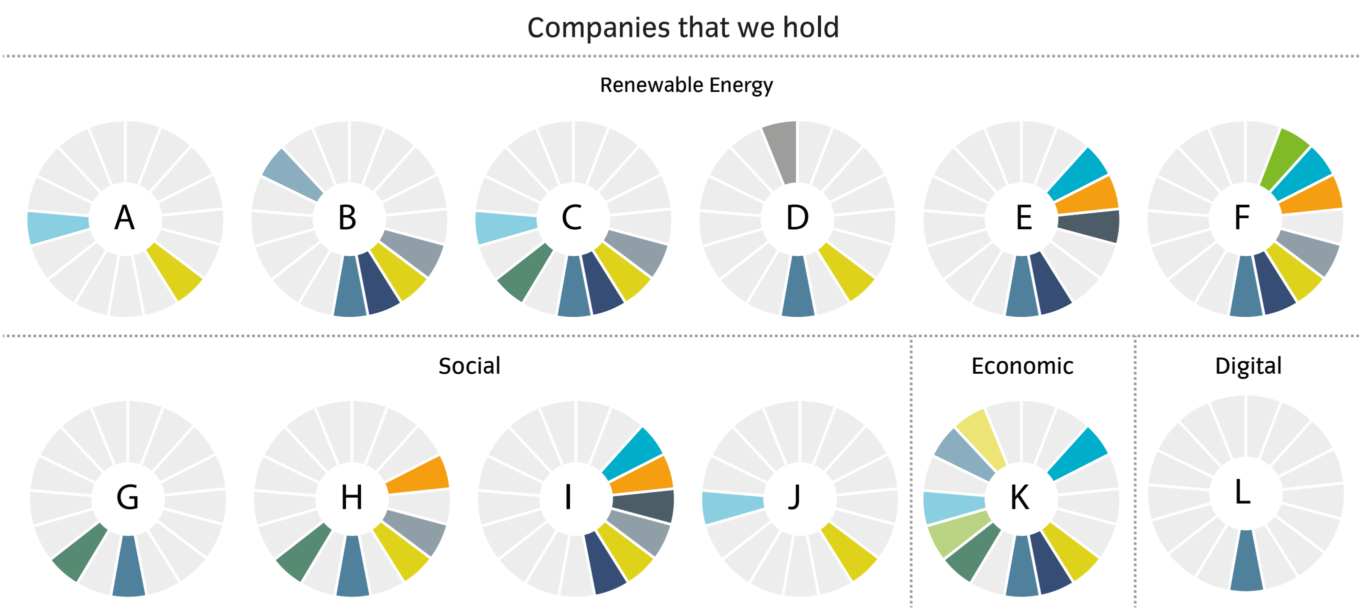
[6] MOBLIST is a programme focused on mobilising public markets to catalyse new scalable and replicable financial products that support the Global Goals and net-zero transition. For more information see https://www.ukmobilist.com/

WE TARGET INFRASTRUCTURE INVESTMENTS THAT CONTRIBUTE TO UN SUSTAINABLE DEVELOPMENT GOALS

Infrastructure holdings play an important role in helping economies achieve UN Sustainable Development Goals. Investments within social infrastructure typically support sustainable development of communities while renewable energy infrastructure facilitate provision of affordable and clean energy.

Examples of companies in which we invest and the UN Sustainable Development Goals they assist with





IMPORTANT INFORMATION

RISK DISCLOSURES

Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

The performance results shown, whether net or gross of investment management fees, reflect the reinvestment of dividends and/or income and other earnings. Any gross of fees performance does not include fees and charges and these can have a material detrimental effect on the performance of an investment.

Any target performance aims are not a guarantee, may not be achieved and a capital loss may occur. Strategies which have a higher performance aim generally take more risk to achieve this and so have a greater potential for the returns to be significantly different than expected.

Portfolio holdings are subject to change, for information only and are not investment recommendations.

ASSOCIATED INVESTMENT RISKS

Multi-asset

Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large movement in the price of the derivative investment.

Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.

The investment manager may invest in instruments which can be difficult to sell when markets are stressed.

Property assets are inherently less liquid and more difficult to sell than other assets. The valuation of physical property is a matter of the valuer's judgement rather than fact.

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