# 2018 MARKET OUTLOOK
## THE ROAD AHEAD FOR INFRASTRUCTURE

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As we move into 2018, Co-CEOs and Co-CIOs Nick Langley and Richard Elmslie, present RARE's view on the market and what it will mean for global listed infrastructure investors.

### Q. WHAT WERE THE KEY MACROECONOMIC EVENTS OF 2017?

2017 was a year defined by politics. In the United States (US), investors started the year with confidence that President Donald Trump would be able to execute his pro-growth platform which would be highly beneficial to markets.

While the actions of President Trump dominated headlines throughout the year, it was only in December that President Trump was able to sign the much-anticipated tax reform bill into law. This law will lower corporate and individual tax rates and represents the most significant overhaul of the US tax code in over 30 years.

Given the benefit of this reform to US corporate earnings, the market reacted positively to this news.

Moving across to Europe, the market had a mixed response to various political events within the region. Markets were pleased with Emmanuel Macron's victory in the French Presidential election, however the separatist movement in Catalonia in Spain did give rise to investor concern.

Elsewhere in the region, the United Kingdom remained consumed with Brexit implementation issues.

### Q. MOVING INTO 2018, WHAT ARE THE KEY MACRO ISSUES SHAPING THE INVESTMENT LANDSCAPE?

Moving into 2018, inflation is a key area of focus. At present, we expect the world to diverge in terms of inflationary pressures. It's important to note that some inflation is healthy for an economy. For instance, wage inflation is necessary to reduce underemployment, encourage movement up the job quality scale and promote re-entry to the workforce. Additionally, some inflation is also important for asset prices.

We believe that this is where the central banks' involvement will be quite significant, and as we move into 2018, it will be a topical issue to follow closely. In the US, we see the US Federal Reserve continuing to raise rates to further reduce the currently accommodative monetary policy. In Europe, the European Central Bank (ECB) is set to reduce quantitative easing (QE) – a transition that is difficult to implement steadily.

Additionally, we believe that politics will continue to play a key role in driving swings in investors sentiment. This is something that markets tend to forget. Concerning Europe, we are at quite a pivotal point given the Brexit overhang, as such, the implementation of Brexit at a macro and company-specific level is something that we are closely following.

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**Key takeaways**

- Some inflation is important, need wage inflation to reduce underemployed and increase participation rates.
- Central bank activity likely to drive rates.
- Politics and geopolitics still has a role to play.

## Q. WHAT ARE THE KEY THEMES THAT YOU BELIEVE WILL DRIVE THE INFRASTRUCTURE MARKET IN 2018 AND WHY?

As it relates to global listed infrastructure, we believe that three key themes will be driving markets in 2018.

### 1. Asset-based growth

Across the board, companies are continuing to invest in their underlying assets to generate returns in the future. Given that asset prices are quite high at the moment, and these companies are trading at elevated multiples, asset-based growth has become a topical issue. To alleviate investor concerns, companies need to demonstrate that they have avenues of growth to support those multiples.

As it relates to regulated utilities, some companies achieving somewhere between 7% and 10% per annum in asset-based growth. Regulators are providing these companies with an 8% to 10% return on the equity, which in turn, is being invested into the company's underlying assets. This investment supports cash flow, earnings and dividend growth.

### 2. Price elasticity of demand

Put simply, price elasticity of demand considers the impact of price increases on the usage and affordability of a company's assets. In other words, as prices steadily increase, companies need to be careful that they continue to retain consumer usage of their assets. This is important for infrastructure companies that own user-pay assets. These companies need to ensure that motorists are using their roads and passengers are going through their airports.

Some companies have concession agreements in place that dictate by how much they can increase their prices. Given this legal framework, it is a question of whether these companies will retain the same level of demand and usage as prices increase. As usage of these assets are linked to economic growth, we believe that as long as we continue to see strong underlying economic growth, these companies will continue to see an increase in revenue and cash flow growth, which is supportive of earnings and dividend growth.

### 3. Technological disruption

Moving into 2018 and beyond, we may start to see some differentiation around technology disruption. Investors are starting to consider, and be wary of, the impacts of changes in technology on the way we utilise our infrastructure, and there may be some winners and losers out of that. Some examples of disruptors within the infrastructure sector include: the falling cost of battery energy storage, greater penetration of renewable power generation, increased inter-connection of electricity networks, and the greater prevalence of electric vehicles.

**Key takeaways**

- Asset-based growth, no issues with funding, it's more about the opportunities.
- Price elasticity of demand for economically sensitive assets could interrupt usage/patronage.
- Early days, but may begin to see some differentiation on potential technology disruption.

## Q. WHAT ARE THE POTENTIAL IMPACTS ON KEY SECTORS AND INDUSTRIES?

With respect to utilities, rate (or asset) base growth continues to drive earnings and dividend growth over the foreseeable future. There are two key hurdles to growth:

1. There must be investment opportunities to grow the asset base.
2. There must be an environment where the regulators are supportive of spending. For example, companies operating in south-eastern states in the USA are investing in storm hardening against hurricanes to improve reliability of the

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networks. This is supported by regulators. Other regions, such as California, which are more advanced in terms of electric vehicles (EV) will start building and investing in EV charging stations, and that will drive rate based growth.

With respect to infrastructure, we are relatively confident in next year's economic growth prospects. From a macro perspective, we are also benign on bond yields, subject to the central banks not doing anything unexpected and the markets overreacting to that. As a result, we expect continued growth in usage/patronage for infrastructure companies but expect some pressure on achieved prices, impacting revenues.

**Key takeaways**

- On the utilities side, asset base growth resulting in positive EPS/DPS impact.
- On the infrastructure side, we expect to see volumes grow but achieved price increases begin to moderate.

## Q. HOW SHOULD LISTED INFRASTRUCTURE INVESTORS POSITION THEMSELVES GOING INTO 2018?

RARE believes the macroeconomic environment to be relativity benign. Market expectations for earnings growth for stocks are elevated, and therefore the risk of disappointment is skewed to the downside. As a result, in 2018 we expect a stable operating environment, but recognise that any deviation from expectations could cause an outsized movement in asset prices. While there may be volatility, we do not expect any major corrections as there is still significant cash on the sidelines waiting to "buy the dips" .

**Key takeaways**

- RARE believes the macro environment is relatively benign.
- Markets (asset prices) are elevated and hence sensitive to disappointment.
- Still, significant cash waiting to buy the dips.

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EPS refers to Earnings per share and DPS refers to Dividends per share


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