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Russell Investments,

Outlook for the listed infrastructure asset class

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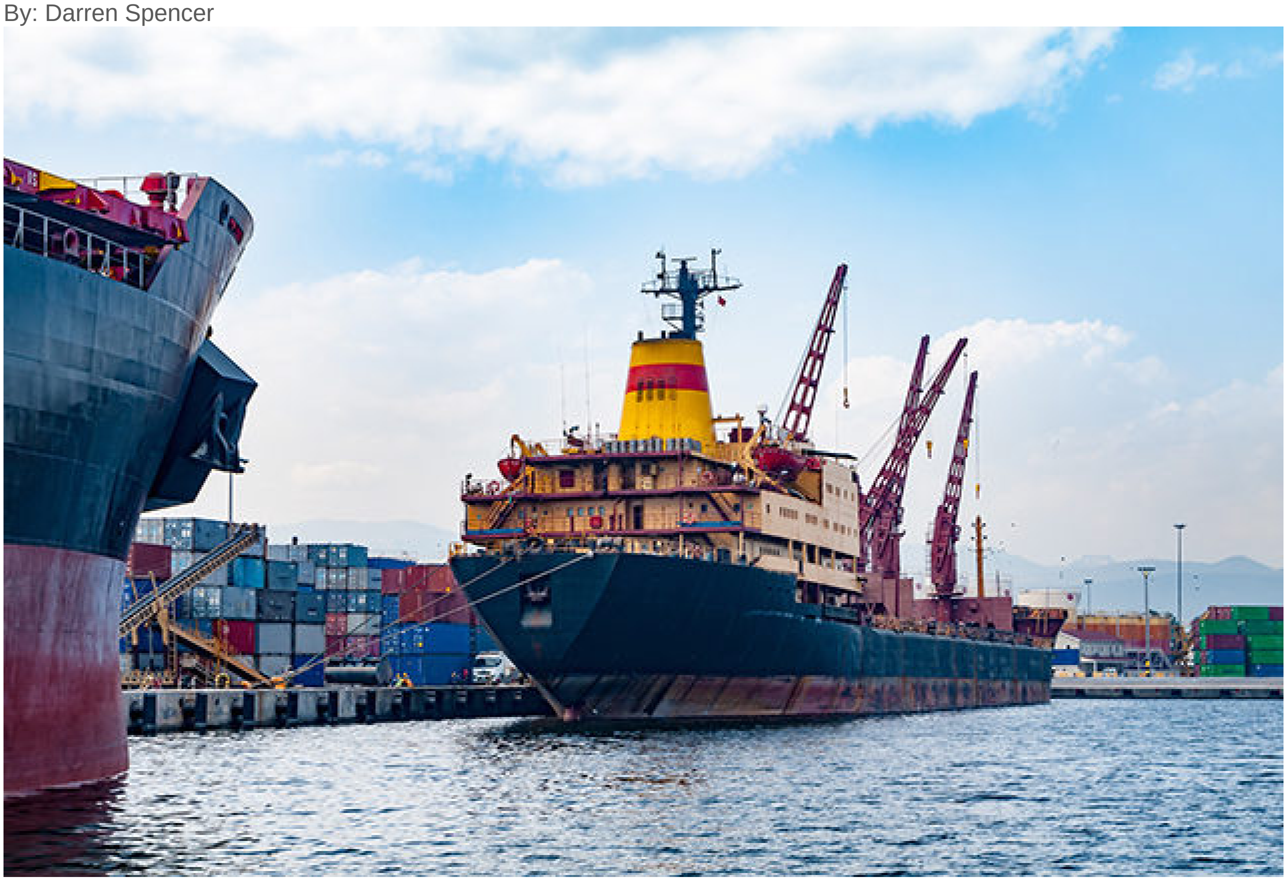

Infrastructure has been in the headlines quite a bit in the past year, with both U.S. presidential candidates campaigning on the need for significant spending to modernize and improve this fundamental building block to the functioning of modern society. In anticipation of these plans coming to fruition and potentially benefiting the listed infrastructure asset class by creating more opportunities for the private sector to build, own and operate critical infrastructure assets, the S&P Global Listed Infrastructure Index returned 11.45% in 2016. At the same time, infrastructure assets have historically come under pressure during periods where 10-Year U.S. Treasury yields have risen sharply in short periods of time. So, what factors should investors today consider when contemplating including infrastructure within a multi-asset portfolio?

A quick primer on listed infrastructure

- **Interest in infrastructure investing is not a new phenomenon.** Pension plans around the world have been attracted to this asset class since the early 1990s and have helped the market capitalization of the broad universe of publicly traded infrastructure companies grow from approximately $500 billion in the early 2000's to around $2-3 trillion today based on Russell Investments' estimates as of December 31, 2016.
- **The attractive characteristics of "pure play" infrastructure** Within the broad infrastructure investment universe, investors may want to consider focusing on "pure play" infrastructure, like airports, toll-roads, sea-ports, electricity transmission & distribution assets and hospitals. These types of assets typically provide essential services, operate in monopoly-like competitive positions and enjoy sustainable cash flows producing reliable income streams.
- **The three-fold case for considering listed infrastructure within a multi-asset portfolio.**
- **Access to a global growth opportunity.** Upgrading the world's infrastructure will be a dominant theme over the next 20 years. In fact, per a McKinsey Global Institute estimate, a staggering $57 trillion will need to be spent on

critical infrastructure by the year 2030 to keep up with projected global demand.[1] In addition, given the cash-strapped positions of many governments and municipalities, there will increasingly be a reliance on private capital to finance infrastructure spending needs.

- **Enhanced yield potential relative to equities and bonds.** Infrastructure companies have historically provided a relatively high dividend yield, but importantly, they have also exhibited predictable and resilient cash flows.
- **Diversification and potential downside protection.** Historically a defensive alternative to equities, exposure to infrastructure has the potential to help manage total portfolio volatility given its forecasted low correlations to stocks, bonds and real estate. Low correlation means the prices of infrastructure stocks have historically moved in a different pattern and are influenced by different market factors.

Infrastructure and interest rates

Historically infrastructure assets have responded negatively to sharp increases in the 10-year U.S. Treasury yield. For instance, as the chart below shows, the S&P Global Listed Infrastructure Index dropped -10.4% (May 1, 2013 - May 24, 2013) in response to the 91 basis point spike in the 10-year U.S. Treasury yield during the "Taper Tantrum" in 2013, following comments by then Federal Reserve Chairman Ben Bernanke, that the Fed may reduce debt purchases; the index also declined -11.0% (Sept. 8, 2016 - Nov 14, 2016) in the immediate aftermath of President Trump's election victory when the 10-year U.S. Treasury yield rose 66 basis points.

That said, it is important to note that:

- **Performance of infrastructure assets has tended to improve** after the initial shock of higher rates dissipates and markets begin to refocus on the underlying fundamentals of the infrastructure asset. Case in point: in the 12 months following the Taper Tantrum, the S&P Global Listed Infrastructure Index returned 32.3% (June 25, 2013 - June 24, 2014).
- **Not all infrastructure sectors are impacted in the same way by rising interest rates.** Electric utilities have typically exhibited the most interest rate sensitivity given their bond-like cash flows and high yields. In contrast, sectors like railways, marine ports and airports have been less sensitive to rising rates because they are impacted more by user demand and economic activity.

	"TAPER TANTRUM" 5/1/2013 – 5/24/2013	FOLLOWING 12 MONTHS 6/25/2013 – 6/24/2014		9/8/2016 – 11/14/2016	FOLLOWING 12 MONTHS
S&P Global Infrastructure Return	-10.4%	32.3%	S&P Global Infrastructure Return	-11.0%	?
Change in 10-Year U.S. Treasury Yield	+91 bps	+4 bps	Change in 10-Year U.S. Treasury Yield	+66 bps	?

Source: Russell Investments. As of December 31, 2016
Index returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment. Indexes are unmanaged and cannot be invested in directly.

[1] Source: McKinsey Global Institute Report. *Infrastructure Productivity: How to save $1 trillion a year.* January 2013.

Bottom line

Infrastructure has been in the headlines quite a bit recently given political priorities globally - not just in the U.S. - for investing in the improvement of these critical assets. As noted, sharply rising 10-Year U.S. Treasury yields may be a headwind to listed infrastructure assets, but performance tends to improve over time as the initial impact of higher rates wanes and the market refocuses on underlying fundamentals. Depending on your clients' goals and risk tolerance, now may be a good time to consider including listed infrastructure investment opportunities in a multi-asset portfolio.

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The S&P Global Infrastructure Index: Provides liquid and tradable exposure to 75 companies from around the world that represent the listed infrastructure universe. To create diversified exposure across the global listed infrastructure market, the index has balanced weights across three distinct infrastructure clusters: Utilities, Transportation, and Energy.

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