COHEN & STEERS

Private and listed infrastructure: The case for a complete portfolio

by **Tyler Rosenlicht** and **Joseph Handelman, CFA**

We believe it is time for asset allocators to add a listed component to their private infrastructure investments.

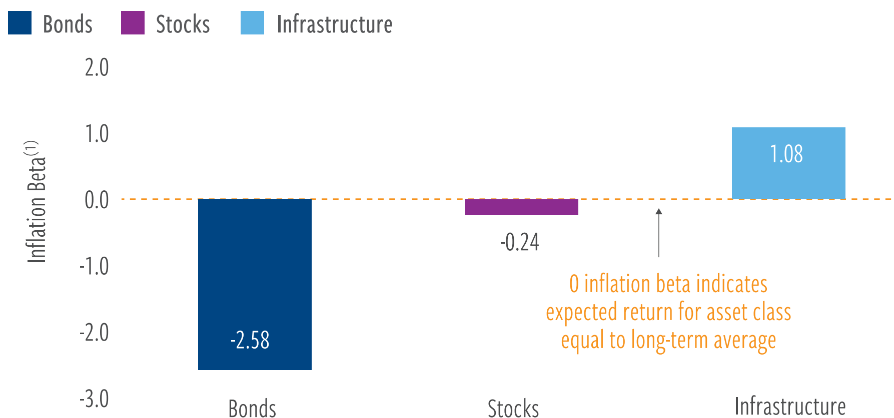
The global economy has entered a new regime, characterized by higher interest rates, higher inflation and low growth.

It is a market that we believe will position infrastructure—both listed and private—as an asset class that can drive strong relative and absolute performance. Infrastructure has a) pricing power via regulation or contract; (b) high margins with significant operating leverage; and (c) strong balance sheets with long duration and fixed rate debt. The result is that infrastructure may provide equity-like returns complemented by attractive downside capture, particularly when inflation surprises (Chart 1).

EXHIBIT 1

Infrastructure has outperformed when inflation surprised

% Outperformance vs long-term average for every 1% y/y inflation surprise (January 1978–September 2022)



At September 30, 2022. Source: Bloomberg and Cohen & Steers.
Data quoted represents past performance, which is no guarantee of future results. There is no guarantee that any historical trend illustrated above will be repeated in the future, and there is no way to predict precisely when such a trend will begin. The information presented above does not reflect the performance of any fund or other account managed or serviced by Cohen & Steers, and there is no guarantee that investors will experience the type of performance reflected above. (1) Inflation beta was determined by calculating the multivariate regression beta of 1-year real returns to the difference between the year-over-year realized inflation rate and lagged 1-year ahead expected inflation, including the level of the lagged expected inflation rate. Expected inflation as measured reflects median inflation expectation from University of Michigan Survey of 1-Year Ahead Inflation Expectations. Beta is a measure of the volatility of a security or a portfolio in comparison to the market as a whole. A real rate of return is the annual percentage return realized on an investment, which is adjusted for changes in prices due to inflation. Stocks represented by S&P 500 Index. Bonds represented by ICE BofA U.S. 7-10 Year Treasury Index. Infrastructure represented by 50/50 Blend of Datastream World Pipelines and Datastream World Gas, Water, & Multi-Utilities through December 2002; Dow Jones Brookfield Global Infrastructure Index thereafter.

KEY TAKEAWAYS

We believe listed infrastructure can serve as a complement to private infrastructure as our analysis shows they have offered similar returns, volatility, equity market correlations and diversification benefits.

Allocations to both listed and private provide diversification as well as complementary alignments to ESG, while helping investors optimize their portfolios across liquidity, risk, asset exposure, and other preferences.

We believe allocations to infrastructure can drive strong relative and absolute performance given the global economy has entered a new regime, characterized by higher interest rates, higher inflation and low growth.

Yet, institutions appear to be struggling to deploy capital quickly enough to meet existing infrastructure allocations. Research from Preqin estimates that sovereign wealth funds, endowments, public pensions and other institutional investors have only funded 70% of their targets (Chart 2).

EXHIBIT 2

Institutional investors are under-allocated to infrastructure

Preqin data as of 12/31/21. Average of 792 institutional investors.

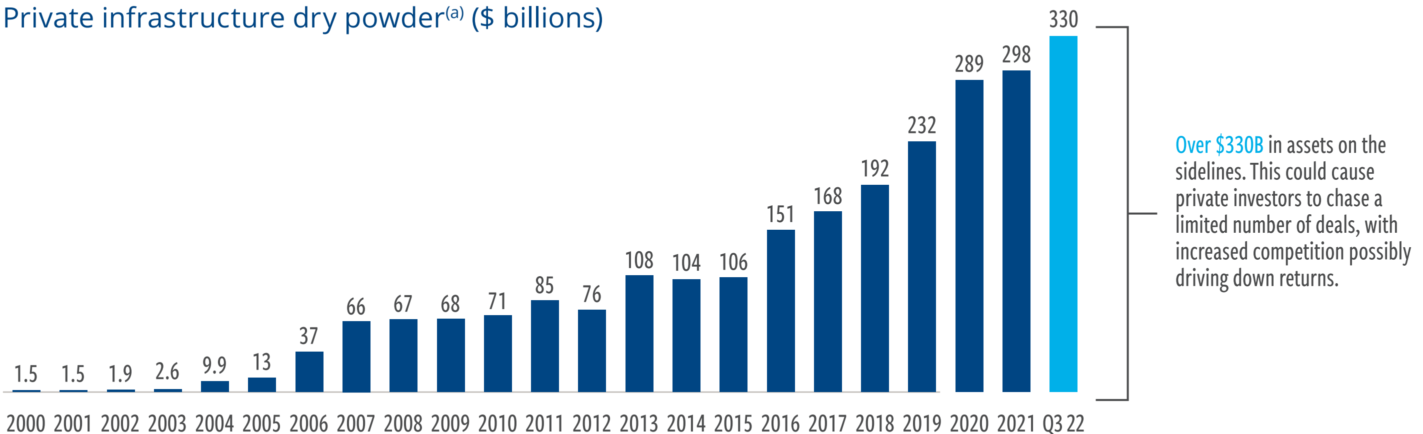
We believe one contributing factor to this trend has been the difficulty private funds have faced sourcing and completing investment opportunities in private infrastructure, which tend to be big, complex, and often regulated. Infrastructure assets represent the backbone of the global economy, which can make finding, evaluating, structuring and completing large-scale acquisitions more challenging and time consuming than other asset classes.

This has resulted in a significant buildup of dry powder (Chart 3) that may dilute forward returns for private investors given the substantial competition to deploy capital into the asset class. This can be seen from the ongoing trend of private infrastructure firms acquiring divisions or the entirety of listed companies in "take-private" transactions.

EXHIBIT 3

Dry powder is building up among institutional investors

Private infrastructure dry powder[(a)] ($ billions)



At September 30, 2022. Source: Preqin

There is no guarantee that any historical trend illustrated above will be repeated in the future, and there is no way to predict precisely when such a trend will begin. There is no guarantee that any market forecast set forth in this presentation will be realized. (a) As defined by Preqin, Dry Powder is the amount of capital that has been committed to a private equity fund minus the amount that has been called by the general partner for investment. Preqin Dry Powder figures represent dry powder for all private funds reporting data at June 30, 2022, unless otherwise noted.

We believe listed infrastructure represents an attractive alternative for investors seeking to gain exposure to the asset class. The challenge, however, is that many investors are holding onto misperceptions of the benefits of private infrastructure over listed.

Among those misperceptions are that private infrastructure offers better returns, lower volatility and lower equity correlations. There is also a belief among investors that private infrastructure offers exposure to a wider investment universe as well as a greater ability to invest according to environmental, social and governance (ESG) principals.

We think those perceptions are misguided. Listed infrastructure compares well to private across all those attributes. In fact, we see private and listed infrastructure as complementary allocations.

We conducted detailed analysis to compare listed infrastructure strategies with private fund options to dispel those misperceptions. We want to educate investors and provide portfolio solutions, as well as help investors gain confidence in the potential for listed infrastructure to serve as a complement to their private allocations.

We used data from the Burgiss Private-I platform to evaluate key characteristics of private and listed infrastructure and to quantify the similarities and differences between the two approaches to investing in the asset class. We hope this helps investors optimize their portfolios and meet their objectives.

Our conclusion: We believe investors should consider allocations to both listed and private infrastructure. Data shows they have offered similar returns and volatility, as well as similar correlations with global equities. And allocations to both private and listed can give investors diversification and ESG alignment while helping them to fulfill their target allocations.

In short, we found that listed and private infrastructure universe definitions are comparable. Both generally classify infrastructure similarly and pursue common investment themes: (1) owners and operators of large-scale real assets that underpin global economic activity; (2) regulated, concession-based or contracted revenue in high barrier-to-entry businesses; (3) long-duration cash flows that are predictable in nature; (4) inflation-linkages that can help provide investors high inflation sensitivity and (5) attractive downside capture relative to traditional equity markets.

Further, the underlying sectors in which the listed and private managers tend to invest are broadly comparable, with most investments going into transportation, utilities, communications and energy infrastructure. And where there are differences – notably company size, geographic mix, and sector diversification – we see those differences as complementary, providing a wider opportunity set for those investors who utilize both private and listed.

How did we source the data for this analysis?

Burgiss is a global, market-leading provider of private capital investment information with over 30 years of expertise and is 40% owned by MSCI. Private-I is a sophisticated research tool that provides flexible access to a more robust and higher quality data set than is available via competing providers. The returns from this data source represent net returns experienced by private fund investors and is sourced from LP financial statements and validated by the Burgiss team. It contains detailed information from 290 private infrastructure funds launched since 2004. Other data sets typically rely on estimates, third-party audits or appraisals to estimate returns generated by private funds or focuses on asset-level operating performance instead of the LP investment experience. We believe Burgiss provides the best data for the net, after-fee returns actually experienced by the investors.

We believe investors should consider allocations to both listed and private infrastructure. Data shows they offer similar returns, volatility and low correlations with global equities.

For instance, listed markets tend to represent larger companies, while private tends to focus on smaller opportunities. In addition, listed managers are able to create more diversified portfolios, while private managers tend to have more concentration risk given the investment "check sizes" required by the industry. Given the scale of the broad universe, we also found that some private managers focus on specific sectors (such as renewables or digital infrastructure), which can give investors targeted exposure to specific themes but is done at the cost of a more balanced approach.

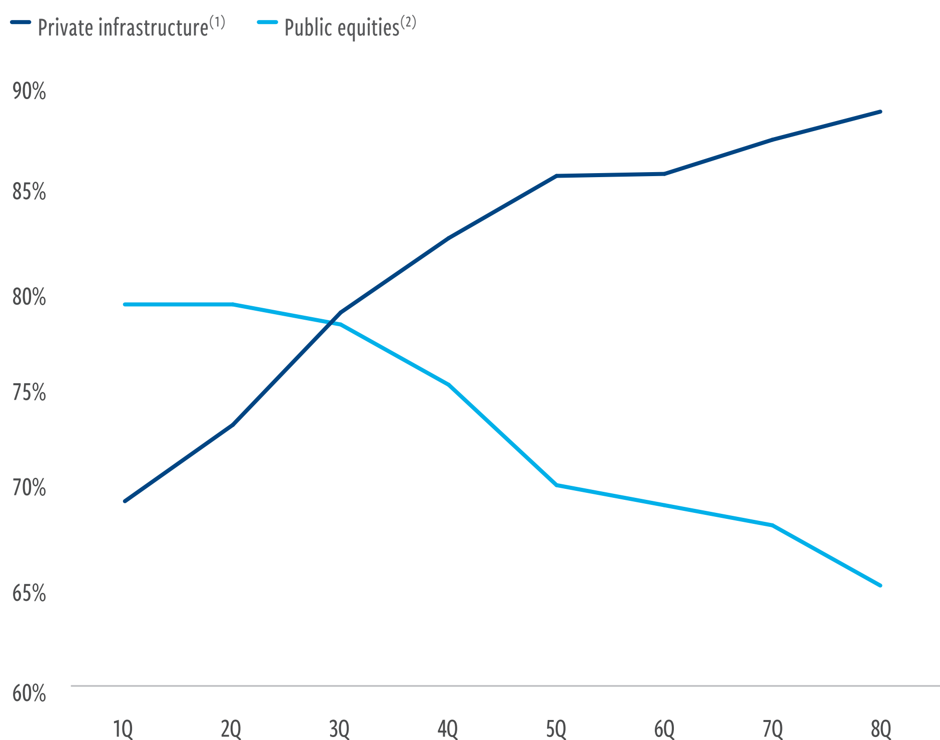
A closer look at correlations

We believe one significant misperception is that listed infrastructure is more correlated to equities than private options. In fact, listed and private returns are more closely correlated to each other, especially over longer holding periods. It's true there is a higher correlation between listed infrastructure and global equities over very short-term holding periods, but after just three quarters, the correlation of listed infrastructure to private infrastructure is greater than its correlation to equity markets (Chart 4). Data shows listed and private returns display a correlation above 90% over holding periods greater than two years.

EXHIBIT 4

Listed infrastructure correlates to private infrastructure over longer periods

GLI holding period correlations



At March 31, 2022. Source: Burgiss Private iQ U.S., UBS, FTSE Russell, S&P

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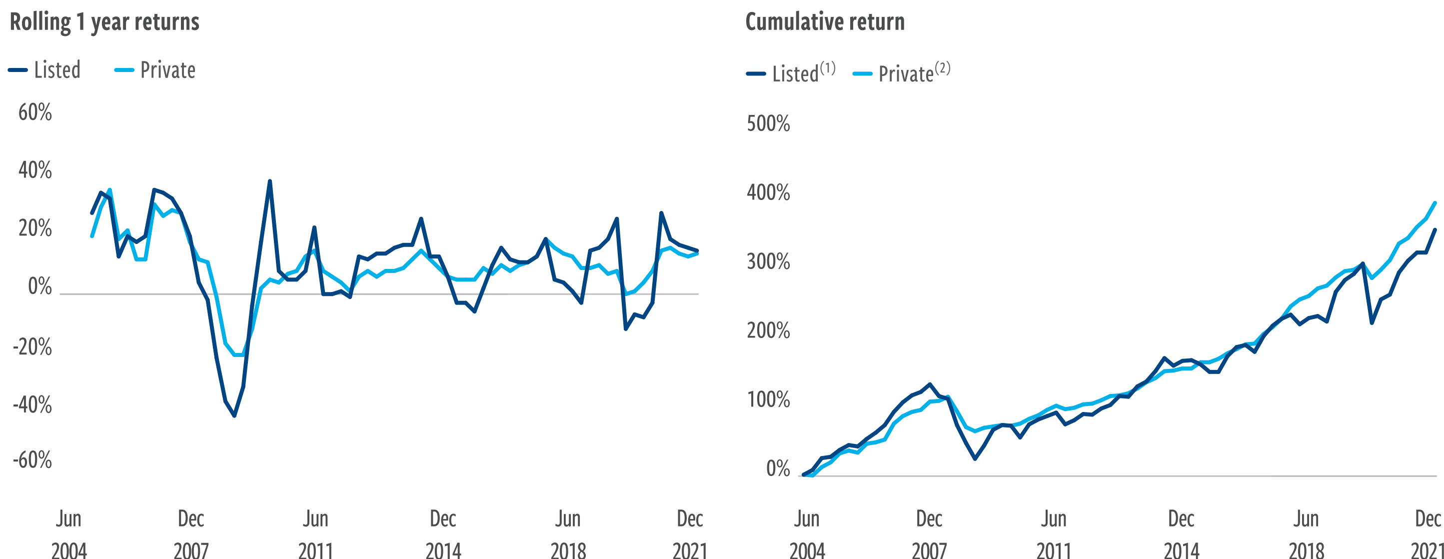
Our analysis also shows that listed and private infrastructure exhibit similar return profiles through the cycle. And while volatility appears lower for private funds, biases found in many commonly cited private infrastructure indices influence the comparison between listed and private volatility profiles. We find, using commonly accepted volatility adjustments, that listed and private actually have similar volatility. This stands in contrast to some investor perceptions that private infrastructure is less volatile and better performing than listed, which is how the data appear at first glance.

In the long run, net returns to investors in listed infrastructure have historically been in line with private. This is demonstrated in both rolling one-year returns and in cumulative returns based on pooled internal rates of return (IRR) across vintage years (Chart 5). Notably, these returns do not factor in an illiquidity discount or leverage differences. Private funds tend to utilize more leverage and should offer a premium return given the illiquidity of fund investments, which has not been the case.

EXHIBIT 5

Net returns in listed infrastructure are in line with private



At March 31, 2022. Source: Burgiss Private iQ U.S., UBS & FTSE Russell
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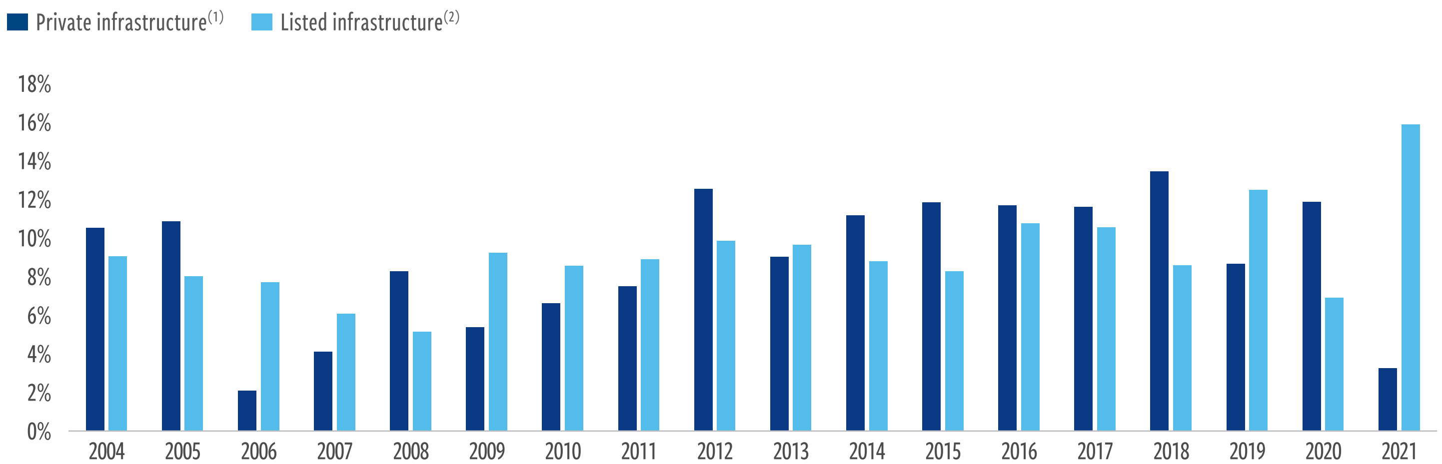
We also made a comparison of performance by vintage year. We compared the IRR for each private vintage to the annualized return from the listed benchmark assuming a similar start date. The commonly held misperception is that private almost always outperforms listed when the reality is that they are nearly even.

We observe that vintage year returns were better for listed 44% of the time (Chart 6). Notably, this is before comparison adjustments are made for leverage and illiquidity in private markets, which we believe should provide a meaningful return premium. The evidence seems to point to fees and carried interest eating into private net returns over time compared to listed benchmarks.

EXHIBIT 6

Listed and private vintages have performed similarly

Private vs. Listed, by Vintage



At March 31, 2022. Source: Burgiss Private iQ U.S., UBS & FTSE Russell
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Appraisal process influences volatility

Volatility of private and listed infrastructure also merits more analysis. At first glance, listed returns exhibit more volatility than private. However, private equity quarterly returns are predominantly driven by appraisals and other non-transactional valuation techniques that create a smoothing effect and may retain biases and other volatility dampening impacts.

Many private funds and infrastructure indices rely on comparable sales or auction values with imperfect information, or smoothed Discounted Cash Flow (DCF) processes that remove outliers to assess the 'fair value' of assets each period. In a recent report, EDHECinfra, a firm that specializes in valuation analytics for unlisted infrastructure, went so far as to state, "We have established the reported appraisals and the discount rates used to compare them are not a fair representation of market prices…to put it simply and bluntly, they are wrong."

Further, private indexes fail to capture the effect of things like fees and capital calls, which weigh on returns and the IRR.

Appraisals typically work by using the previous value and updating it with the most recent market information. This means that current appraisals built on top of older appraisals incorporate past information rather than current prices being determined in isolation with each new period, divorced from previous appraisals.

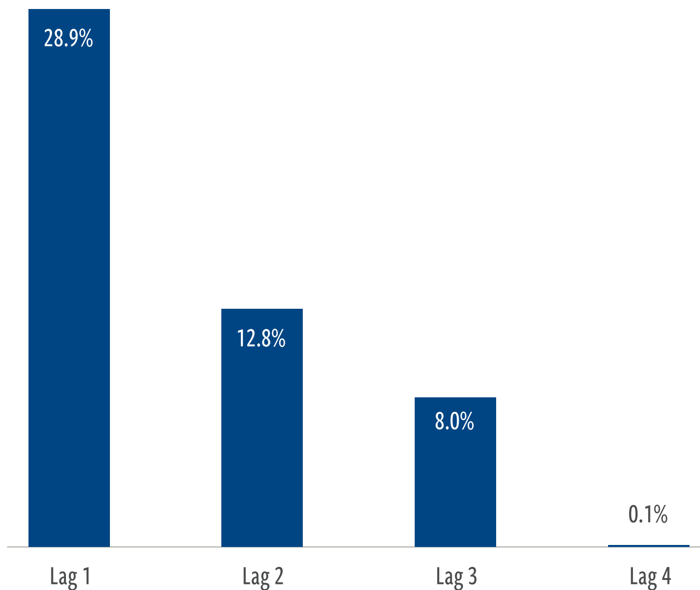
This methodology demonstrates how biases can make their way into the analysis. A more precise and, we think, current appraisal would represent the value of the asset at a specific point in time. Listed infrastructure, by definition of being publicly traded, is valued continuously and transparently.

One measure of how the appraisal process for private infrastructure dampens volatility is the autocorrelation in the private return time series. Autocorrelation refers to the degree of correlation of the same variables between two successive time intervals. It helps answer the question, how much does recent experience influence current values? When we analyzed the Burgiss data set, we observed autocorrelation in the return stream. However, we found that the autocorrelation appears to vanish after four quarters (Chart 7).

EXHIBIT 7

Smoothing effect of appraisals for private vanishes over time

Private infrastructure[1] autocorrelation



At March 31, 2022. Source: Burgiss Private iQ U.S., UBS & FTSE Russell
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(1) Private infrastructure represented by Burgiss Infrastructure Pooled IRRs (all vintages, 2004–2021)

How we calculate risk-return profiles of private and listed infrastructure

Many of the most useful statistical portfolio calculations require arithmetic returns as an input to calculate risk-adjusted returns, a common optimization objective for professional investors. Arithmetic returns indicate the most likely return an asset will earn over a fixed investment period. It is commonly estimated using a simple average across all periods in a sample history. For listed and private infrastructure these estimates are 9.8% and 9.4% per annum, respectively.

The end investor, however, is more concerned with the annualized rate of return they are expected to receive over multiple investment periods. Because returns vary from period to period and compound over time, the degree to which returns vary, also referred to as the volatility, is a necessary input into estimating compound annual growth rates, or geometric return. We can estimate the geometric return from the arithmetic return and volatility. Because cumulative returns are asymmetric with respect to volatility, more volatile investments are expected to have lower geometric returns.

When we apply the volatility adjustment to listed and private infrastructure's arithmetic returns using the reported volatility of the private assets, we arrive at estimated geometric returns of 9.0% and 9.4%, respectively. However, the observed autocorrelations, reporting biases, and appraisal process in private equity leads to high confidence that the reported volatility is not the true risk experienced by private equity holders. The liquidity-adjusted return series for private infrastructure exhibits a volatility of 15.3%. Using this figure to estimate the asset class's geometric returns, we arrive at 8.2%.

This shows that the actual risk-return profiles of private and listed are similar.

As such, we can control for this autocorrelation, using generally accepted methodology, and compare risk and return between listed and private. When doing so we find them to be similar (Chart 8).

EXHIBIT 8

Actual risk-return profiles of private and listed are similar

At March 31, 2022. Source: Burgiss Private iQ U.S., UBS & FTSE Russell
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	Public(1)	Private(2)
Arithmetic return	9.8%	9.4%
Geometric return	9.0%	9.4%
Annualized volatility	14.2%	7.6%
Corrected geometric return		8.2%
Unsmoothed volatility		15.3%

Both investing universes are large

Another conclusion that we think is misplaced: Investors believe that private infrastructure gives them access to a bigger opportunity set than listed.

The reality is both are large. However, the relatively new adoption of listed infrastructure over the last 20 years as a distinct asset class leads some investors to confuse newer with smaller.

The commonly accepted listed infrastructure benchmarks include companies with a total enterprise value in excess of $6 trillion. This includes companies across a variety of sectors, as well as geographies in both developed and emerging markets. Importantly, the universe continues to grow as more companies list shares on public exchanges. Market participants are also considering new sectors that have the investment characteristics of infrastructure companies, such as environmental services.

EXHIBIT 9

Investing universes are large, diverse

Enterprise value ($ in trillions)

As of September 30, 2022. Source: Cohen & Steers, EDHECinfra.

In comparison, EDHEC has recently completed a thorough analysis to examine the private infrastructure universe utilizing the Infrastructure Company Classification Standard (TICCS). It concluded that unlisted infrastructure companies represented $3 trillion by enterprise value.

The size of the investing universe and the complementary nature of private and listed is notable for a key reason. Portfolio diversification is the top reason institutional investors allocate to infrastructure, according to Preqin.

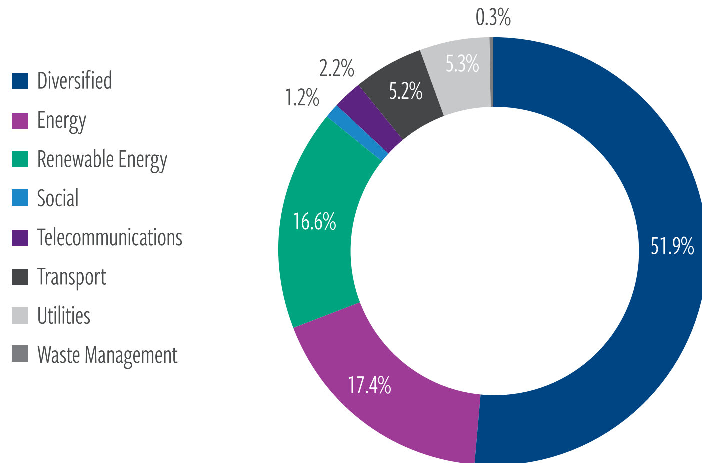
Both listed and private infrastructure are geographically diverse, but their concentrations are slightly different, meaning they can be viewed as complementary. EDHEC has calculated that 57% and 30% of private infrastructure assets are located in Europe and the Americas, respectively. This compares to listed indexes, which typically have 60% in North America and 20% in Asia. Balanced listed and private allocations can help increase geographic diversification.

Listed and private infrastructure are also diverse by sector. We see the differences in concentration as complementary; not just by size of the firms with listed focusing on larger firms and private typically offering exposure to smaller companies, but by type of firm. Listed infrastructure offers exposure to more a more diversified basket of infrastructure companies, which we believe provides unique portfolio exposure. Private is typically much more concentrated. In fact, nearly one half of private strategies are targeted funds, focusing on niches such as renewable energy or telecommunications (Chart 10).

EXHIBIT 10

Nearly half of all private funds have a primary focus on one sector

Private funds by AUM and primary sector



Source: Preqin. Data as of 12/31/2022

We also believe that the ability of listed firms to access capital through equity and debt offerings can be an advantage to financing and pursuing large scale growth programs. Private, by comparison, is more resource constrained.

ESG considerations also critical in listed

Another misperception centers on a growing area of interest to institutional investors: ESG investing. The misperception centers on the fact that some investors seem to believe that it is more effective to integrate ESG considerations into unlisted portfolios.

That is because there is an array of tailored strategies in private investments to specifically focus on clean energy and sustainable transition fuels. There is also a perception that the direct ownership of private infrastructure gives investors more company control and influence when it comes to ESG.

We think that perception is misplaced. As in other areas, ESG investing through listed securities is complementary to private. In fact, we think there are advantages to ESG investing via the listed markets.

Private holdings do not have the same liquidity, transparency and governance structure of listed securities. Notably, listed market investors can vote via proxy to shape best practices and corporate strategies. What's more, owners of listed securities can readily sell their shares if they disagree with the direction of management.

Listed markets, by nature of the public availability of filings, also draw more scrutiny from the press, watchdog groups and a wide array of investors. Owners of listed securities can engage more readily in shareholder activism from direct discussions with management to public advocacy or formal challenges to board seats. This exerts greater pressure on listed firms to improve their ESG strategies, disclosures, and ratings.

When companies make decisions that stand contrary to investor views on long-term return, listed owners can also 'vote with their feet' and sell positions much more easily and with less friction and transaction costs.

Asset managers in listed infrastructure have and will continue to create ESG-aware investment options for clients who have a desire to reflect certain values in their allocations. Creating ESG-focused investment strategies is not just the domain of private markets.

Listed companies can also adapt to changing market fundamentals; For instance, midstream energy companies have invested over $20b in recent years in an effort to capitalize on de-carbonization trends and initiatives.

Manager selection matters

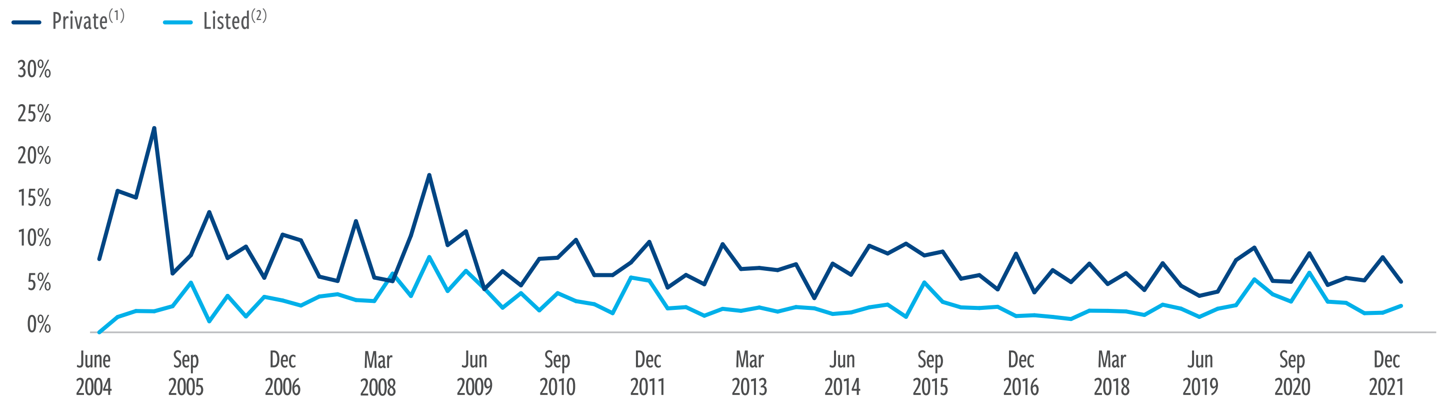
Finally, our analysis shows that manager selection matters. Though there is dispersion of returns by manager in both listed and private, the dispersion between the best and worst private infrastructure managers is wider. The reward for picking right is high, but the penalty for choosing incorrectly is steep especially in a private allocation (Chart 11). The range of outcomes is lower when selecting listed infrastructure managers, and we believe this is likely due to: (1) the fact that private funds may offer more bespoke, niche and targeted allocations (i.e., transport or renewable focused) while listed tend to provide more uniformly diversified approaches to the asset class (i.e. beta effect) and (2) large-asset or concentration risk inherent in many private funds.

We believe infrastructure will continue to provide attractive investment opportunities in the current investment regime. We believe that investors should seek exposure to the asset class through both listed and private markets, given the similar—and potentially complementary—return profiles and underlying business characteristics of the two investment universes.

EXHIBIT 11

Manager selection matters but less so in listed

Inter-Quartile Range (75th–25th Percentile)



At June 30, 2022. Source: Burgiss Private iQ U.S., eVestment

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How institutions are allocating to listed infrastructure

As investors increasingly allocate to listed infrastructure, particularly given inflation is expected to remain stubbornly high, we see investors using private and listed infrastructure as complementary. We see investors using both to tailor their portfolios according to their objectives (see chart).

As institutional investors have ramped up their use of listed infrastructure, we have observed a variety of implementations tailored to investors' differing objectives. These include:

An entire infrastructure allocation:	seen as an effective and cost-efficient way to implement a broadly diversified allocation to infrastructure and reap the long-term investment benefits of the asset class
A core infrastructure allocation:	typically combined with opportunistic or sector-specific private infrastructure investments to enhance returns or deliver specific social or environmental impacts
A liquidity tool:	– to be drawn down to fund capital calls on a private infrastructure strategy – to enable tactical or strategic rebalancing as asset class and capital market assumptions change – and/or to capture timely mispricing and arbitrage opportunities
A tailored completion strategy:	for investors seeking to fill sectoral or regional gaps in their private allocations

We are excited by the fact that institutional investors are increasingly embracing the opportunity to leverage both private and public markets to optimize their infrastructure portfolios and tailor to their preferences around risk, returns, fees, liquidity, investment horizon and asset exposure. However, it is worth pointing out that this only mirrors what has long been common practice in broad equity investing, with precious few institutions restricting their opportunity set to private markets alone.

About the authors

Tyler Rosenlicht, Senior Vice President, is a portfolio manager for Global Listed Infrastructure and serves as Head of Natural Resource Equities. Prior to joining the firm in 2012, Mr. Rosenlicht was an investment banking associate with Keefe, Bruyette & Woods and an investment banking analyst with Wachovia Securities. Mr. Rosenlicht has a BA from the University of Richmond and an MBA from Georgetown University. He is based in New York.

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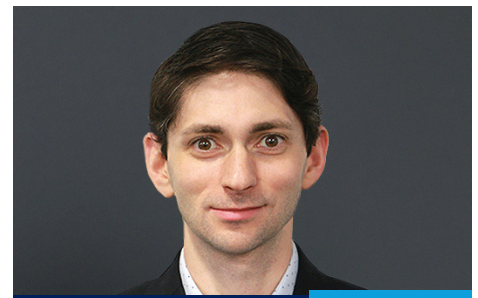

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