Infrastructure

For global professional / qualified / Institutional clients and investors.

Investment outlook

Herd mentality and the 4Ds

Energy, after the vote

Go against the tide, or with the flow?

Exploring the 2025 investment outlook for infrastructure

The macroeconomic backdrop for infrastructure is positive on most counts, including stronger than expected economic growth, above average inflation, and declining interest rates (albeit slowly).

The denominator effect is behind us, after two years of strong public market performance.

Private infrastructure valuations have declined, while competition for deals has also decreased. The 'biggest election year in history of humanity' is also behind us, removing some political uncertainty.

Now that the macroenvironment and sentiment have turned more positive, we think the bears are running out of excuses. We remain optimistic about the industry going into 2025.

However, there is also a simple truth – there is no easy money left in infrastructure. Managers need a deep understanding of the underlying businesses to be successful.

A contrarian approach to secular themes

Despite our positive outlook for the industry, we have to ask an honest question – is there herd mentality in infrastructure markets? We think the answer is ‘yes’.

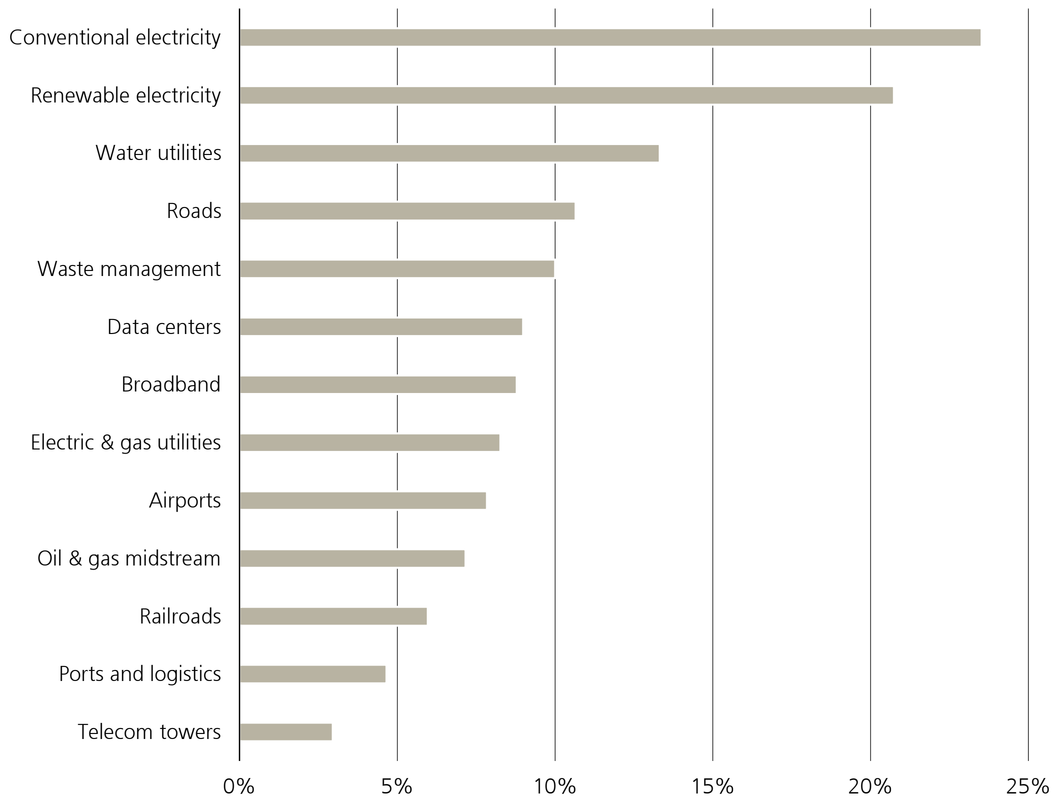
This concern is reasonable, as the same debate is already happening in public markets, where technological disruptions have led to questions about crowded trades and high valuations. Infrastructure is also exposed to disruptive trends and secular themes like the 4Ds – decarbonization, digitalization, deglobalization and demographic change.

To be clear, we remain bullish on these megatrends. We still believe that they will transform our world and provide significant investment opportunities. But it would be dishonest to not acknowledge that there is some hype, especially in clean energy and certain areas of digital infrastructure.

Looking at infrastructure fundamentals though, we notice that consensus earnings (EBITDA) growth for listed infrastructure is quite healthy (see Figure 1). Renewable electricity and data centers are both showing strong growth, which partially explains the positive sentiment. However, what stands out is the strength across all sectors, including roads, waste management and utilities.

These earnings estimates may not show the full picture of private infrastructure fundamentals, but it's difficult to deny that the positive performance of various sub-sectors shows a difference between the general sentiment and actual fundamentals.

Figure 1: Listed infrastructure 2023-26E EBITDA CAGR



Source: Bloomberg, October 2024.

The key is to avoid hype and groupthink when investing in the megatrends. Adopting a more contrarian approach does not mean avoidance. It means being more conservative with deal valuations and underwriting assumptions. This is especially important in hyped up sectors such as data centers and renewables, where fundamentals may be strong, but it is also easy to overpay.

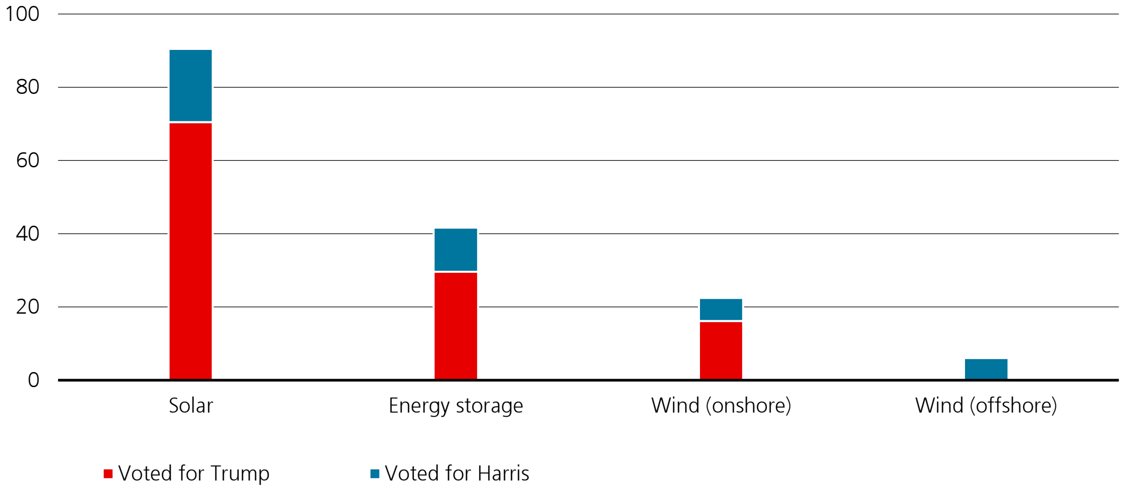
On the other hand, there appear to be overlooked sectors such as power, utilities, and transportation that are fundamentally strong, and should look more attractive in 2025, especially on the back of a stabilized macro environment.

Energy, after the vote

One focus for infrastructure investors is the impact of the recent US elections on the energy sector, as the Republican Party swept the US presidency and congress. Donald Trump has repeatedly talked about repealing the Inflation Reduction Act (IRA), due to his unfavorable view towards renewable energy, as well as a way to fund his planned extension of the 2017 tax cuts.

Many within the energy and infrastructure industry, including ourselves, have argued that the growth in clean energy has mostly benefited Republican-supporting 'red' states. Naturally, this would indicate bipartisan support for legislation like the IRA. For example, 70% of US renewable projects currently under development are located in states that voted for Donald Trump in 2024 (see Figure 2). However, recent surveys show the support for renewables from Republicans is trending down (Figure 3).

Figure 2: US renewable projects under development by state political leanings (USD billion)

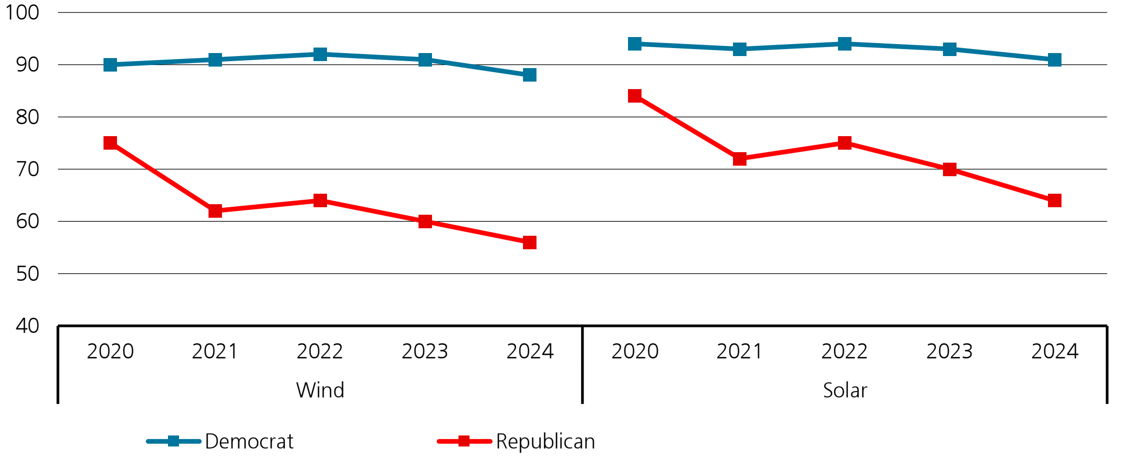


Source: EIA, October 2024.

Taking a more contrarian stance, we have to wonder – if everyone in the industry is repeating the same talking points about the IRA's impact on red states, yet data still shows waning support from Republicans, perhaps everyone is underestimating the risk of an IRA repeal.

Fortunately for energy investors, the evolution of clean energy has never been linear, and swings of the political pendulum are nothing new.

Figure 3: % of US adults favoring more renewables



Source: Pew Research, June 2024.

The clean energy industry has shown significant resiliency and adaptability. What the industry can lean on is the fact that renewable energy remains the lowest cost electricity in most places, even without subsidies. In addition, electricity demand growth has accelerated due to AI and data centers. This means that as an investor, there should be plenty of investment opportunities, regardless of the uncertainties around clean energy policies.

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