AMP CAPITAL'S OUTLOOK FOR REAL ASSETS IN 2019

Investor demand for real assets – infrastructure and real estate – has continued to strengthen in recent years thanks to favourable economic conditions and a low interest rate environment.

In this 2019 outlook, AMP Capital's investment leaders share their insights on what to expect within the various markets for the year ahead.

Boe Pahari
AMP Capital Global Head of Infrastructure Equity

Key trends for 2019: direct infrastructure (equity)

AMP Capital Global Head of Infrastructure Equity Boe Pahari said: "While investors have had some reasons for concern in 2018, overall it was a strong year for infrastructure investing in terms of both financial returns and opportunities – although core infrastructure remained very competitive. The mid-market ($100-500m equity) where we focus is becoming increasingly competitive, but if investors have the sector expertise and origination capability to pursue the right deals then there's a good chance of achieving strong returns given continuing strong deal flow, particularly for investors who can add value with a highly active asset management approach.

Broadly, regional allocation for 2019 will depend where in the value creation cycle investors want to invest, given the contrast between the two major developed infrastructure markets: the US economy is relatively buoyant, while Europe is likely to struggle with ongoing political challenges.

The economic outlook for the US is strong, with rate rises looking likely in 2019, given GDP growth. It's a good time to be invested in businesses with real operational leverage, and in growing sectors such as communications.

Looking through the political noise, Brexit creates potential value propositions for the UK, if you believe in the long-term fundamentals. It seems likely that both the UK and major European economies will face uncertainty and some economic hurdles as trade is impacted. However, periods of uncertainty often bring opportunity for experienced investors looking for long-term value, so we will be looking out for high quality, attractively-priced assets in these countries.

At AMP Capital, we focus on four sectors – transport, communications, infrastructure health, and energy solutions. Each of these sectors is influenced by a disruptive megatrend – globalisation, digitalisation, demographic change and urbanisation – which show no sign of slowing in 2019, bringing further investment opportunities. Among these, the US power and communications sectors stand out, as well as a trend for the growth of regional airports which will benefit some airports in emerging markets such as India, as well as the US and parts of Europe. The broader transport sector in the UK and Europe offers further opportunities.

Looking at the developments in the infrastructure asset class, we expect to see more interest in three growing areas of the market: the 'infra PE' (private equity) space where we focus (midmarket assets with value creation potential), emerging markets, and greenfield/development investment due to the increasing need for new or modernised infrastructure. We expect these areas will be in demand as institutions seek traditional infrastructure characteristics, but also the potential for capital growth. At AMP Capital, we're looking for the right opportunities to extend our sector expertise into emerging markets –airports and social care, including the growing sector of infra health, have great potential.

The most important thing to remember is that infrastructure today looks very different from how it did twenty-five years ago – the world has changed, our lives have changed, and the underlying infrastructure has needed to adapt. The investable universe has moved significantly in these past two decades, becoming broader (for example, the acceptance and rapid growth of communications infrastructure as a part of the asset class). Awareness of the need to keep pace with urban living is crucial for investors and managers. Thought leadership, sector expertise, and origination skill will be key to succeeding in the changing landscape and recognising the opportunities it creates."

Andrew Jones
AMP Capital Global Head of Infrastructure Debt

Key trends for 2019: direct infrastructure (debt)

AMP Capital Global Head of Infrastructure Debt Andrew Jones said: "Strong momentum in the infrastructure debt market over the past 12 months has been driven by significant volumes of infrastructure equity raisings and high levels of M&A activity, particularly in North America and Western Europe. We expect the market will continue to see a strong pipeline of opportunities in 2019, although investors will need to focus more than ever to ensure they target high quality assets in an increasingly volatile economic environment.

"At a regional level, we're seeing increasing demand for infrastructure debt solutions in continental Europe than we've seen historically, including opportunities from the Nordics down to the Southern European states. Again this is driven by a high volume of M&A activity together with continued momentum in the renewable energy market. North America continues to be a strong market for infrastructure debt underpinned by growing telecommunications and energy sectors.

"Telecommunications has been a particularly strong source of deal flow over the past 12 months with significant amounts of capital being required to support growth in the sector including fibre businesses, data centres, telecommunication towers and networks around the world.

"Similarly, we expect to see continued activity in the energy sector as demand increases for renewable energy sources including wind, solar and hydro particularly in Europe.

"Prices of infrastructure assets remain elevated however value for infrastructure debt investors remains attractive as leverage levels remain appropriate while equity buffers in transactions have grown significantly. Employing a focussed investment strategy will be important to keep finding value in 2019 – having an experienced team that can identity assets that are insulated from an increasingly volatile political and economic environment will be critical in determining positive investor outcomes."

Giuseppe Corona
AMP Capital Head of Global Listed Infrastructure

Key trends for 2019: listed infrastructure

AMP Capital Head of Global Listed Infrastructure Giuseppe Corona said: "2018 was a relatively challenging year for global listed infrastructure. Despite solid cash flow generation from the underlying assets, listed infrastructure stock prices have been negatively impacted by a combination of volatility of interest rates, increased political risks, higher regulatory intervention and large asset-specific incidents. As of mid-November, the asset class delivered -4.49%, underperforming Global Equities by 0.50% (in USD as at 21 November 2018).

"We believe 2019 could represent a supportive year for the asset class as its defensive characteristics should start to appeal to investors given the recent increased volatility of global equity markets. Moreover, the underlying valuation of global listed infrastructure is very attractive as investors worldwide can now access a portfolio of core infrastructure assets at or below 11x EBITDA and c. 5% dividend yield.

"Similarly to the last 12-24 months, industry-wide structural investment tailwinds continue to support listed infrastructure. In particular, increased data usage and need for industry rationalisation will continue to drive communications infrastructure, while investments in the utilities sector will be supported by higher penetration of renewable energy. Transportation infrastructure will continue to benefit from a resilient economic growth environment and favourable demographics in emerging markets. Finally, higher US oil and gas production will support capital investment in the energy infrastructure sector."

Carmel Hourigan
AMP Capital Global Head of Real Estate

Key trends for 2019: direct real estate

AMP Capital Global Head of Real Estate, Carmel Hourigan said: "The direct real estate cycle is near its peak with pricing reaching historical highs across all sectors. However, we are still seeing strong global investor sentiment, particularly for Australian direct real estate, with an estimated $300bn USD in capital looking for a home.

"While global, real interest rates remain negative in most developed economies and supportive of acquisition activity, central bank rates are likely to move higher in the medium term, effectively drawing a line under the "lower for longer" thematic.

"As we move into a less capital growth intensive environment, income fundamentals will be paramount to achieving outperformance in total returns moving forward. Real estate managers who focus on the needs of occupiers and customers when managing, leasing or developing an asset, while also taking into account the objectives of investors, will be best placed to deliver sustainable investment outcomes in the long term. This is why investors are increasingly seeking an active asset management approach, as part of the overall real estate management proposition.

"In Australia, our strong economic outlook is supported by record population growth, falling unemployment and robust business and consumer confidence. With this backdrop, the Australian real estate scene is well placed to deliver strong income returns through the cycle.

"Our houseview for 2019 points to CBD office and East Coast prime industrial sectors providing the strongest returns for investors in the near to medium term. Long-term thematics such as rising demand for technology and business services, and the transition of high-volume consumption away from bricks and mortar to online, will drive a different demand model that will favour logistics and office assets.

"The retail sector is continuing to adapt to the impact of e-commerce, tightening household budgets and consumers favouring services over discretionary retail spending. Retail assets able to create a new or enhanced offering that includes convenience and experience will be best placed to attract and retain customers going forward. This approach favours leading regional and neighbourhood centres which our houseview forecasts will outperform on a total return basis over the medium term.

"Core products remain a focus, however as the global cycle matures alternatives such as real estate debt and non-core asset types are becoming steadily more popular with investors looking for better investment performance. For investors looking to maximise returns in a changing cycle, a portfolio mix of core and alternative investment strategies will ensure they are better placed to achieve higher returns over the medium term."

James Maydew
AMP Capital Head of Global Listed Real Estate

Key trends for 2019: listed real estate

AMP Capital Head of Global Listed Real Estate James Maydew said: "Listed real estate plays an important role for investors looking for a more defensive portfolio. With increasing instability from geopolitical challenges and central bank tightening, a greater demand for defensive assets such as real estate in clients' portfolios in 2019 is likely to continue, especially as the fundamentals of supply and demand remain in check globally.

"We believe 2019 will continue to see further allocation of capital towards long-term structural trends, including e-commerce (industrial) and aging demographics (healthcare).

"With the growth of e-commerce players such as Amazon and Alibaba, industrial facilities play a vital role in the economy. At the same time, industrial fundamentals continue to be strong as a multitude of traditional businesses demand new industrial space as they seek to improve the efficiency of their supply chain management to compete with the growing e-commerce competition.

This is occurring at a point in time where industrial floor space in close proximity to the consumer has shrunk due to the conversion of industrial land to the highest and best use, typically residential. This is creating an inflexion point in the industrial real estate market, squeezing rents, capital values, and occupancy to new all-time highs. Valuations are certainly not cheap relative to history and this will continue to be the case in 2019, but growth is underpinned by demand and institutional allocations are growing in the sector and have a long way to go.

"On demographics, as the number of baby boomers increase we will see demand for goods and services that assist their changing lifestyles. One aspect as we age is the increasing need for healthcare services. With an ageing population in many global markets, we expect continued pressure on existing healthcare infrastructure and a significant long-term structural tailwind for real estate owners that offer high-quality health care facilities that match this demand."