Q1 2021 COMMENTARY

For the first quarter of 2021 Infrastructure PLUS was up 1.4%, lagging our infrastructure benchmark (Dow Jones Brookfield US Infra Index) which was up 8.7% as well as the S&P 500 which was up 6.2%. Infrastructure PLUS's strong 2020 performance benefited from the market's preference for growing companies and pandemic "winners" via allocations to sectors such as renewable energy, payments processors, mobile telecom providers, and recovery plays such as rail. The first quarter of 2021 saw a broad rotation into cyclical sectors, such as energy, while creeping bond yields have impacted the present value of growth-oriented technology stocks. Such a rotation was no surprise to us as we fully expected our biggest 2020 winners to take a breather given their massive runs since we took initial positions. While we did slightly reduce our allocation to renewable energy at the beginning of the year, renewable energy and infrastructure technology (think cybersecurity, payment processors, enterprise software) remain our largest sector allocations. We are long-term investors, after all, and we remain confident that the multi-decade tailwinds enjoyed by these companies will far exceed temporary drawdowns which are the result of repositioning by those with shorter investment time horizons. This is not to say that we do not make tactical decisions when we see the opportunity. We boosted our exposure to traditional energy slightly via positions in Enbridge (ENB) and Targa Resources (TRGP) given that we expect oil prices to firm as the world returns to some semblance of normalcy in 2021. We expect this increased demand for refined products (gasoline and jet fuel) to overwhelm production as the oil and gas industry took much capacity offline in 2020 and may not be able to accommodate a vaccinated population rushing to make up for one and half years of quarantine.

Looking back at how the market has performed over the first quarter, the choppy and divergent market reflected both headwinds and tailwinds. The headwinds concern rising inflation risk amidst continuing fiscal stimulus even as unemployment rates continue to fall and a number of industries approach full capacity with materials and worker shortages. In turn, rising inflation could lead to more interest rate increases. Income tax increases, both personal and corporate, could slow economic recovery and derate equity valuations, which at 22.3x next-twelve-month EPS for the S&P 500 are at the highest levels since the tech bubble in 2000. Increased partisanship could also further destabilize US politics and society, increasing equity risk premiums and negatively impacting valuations. But tailwinds are also plentiful and significant. The rising percentage of U.S. and global citizens receiving COVID-19 vaccinations will help accelerate economic reopening. There have been multiple stimulus packages in 2020 to counteract COVID-19 and more ($1.9T) in stimulus passed in 2021. Additional stimulus of $2-$4T are in proposal stages.

The US is also in the midst of multiple transformative trends in renewable energy, as we highlighted in our recent whitepaper (link). Renewable energy costs continue to fall rapidly and policy incentives have been extended. Electric vehicles are becoming more competitive with vehicles powered by the internal combustion engine. Hydrogen has the potential to be another potential source of fuel for the transport sector as costs of production also fall. These forces are contributing to better financial discipline in traditional areas of energy such as fossil-fuel based producers as well as the energy infrastructure players.

5G technology and the rising demand and falling cost of data also continue to further disrupt the way business is conducted and is leading to rising productivity. The economy is becoming increasingly digitized. Technology and COVID-19 are making work-from-home or work-from-remote-locations a permanent aspect of business life and engagement. In turn, these trends are contributing to other trends such as the rising importance of improving the electricity grid, more distributed power generation from multiple sources, a housing boom which is leading to booming demand for materials for both housing construction and the roads and bridges connecting homes and communities. Remote data demands contribute to rising demand for semiconductors, corporate networks, data centers, and cloud computing giving rise to greater demand for data centers, cell tower density, and high-speed broadband access in suburban and rural areas. This is also leading to greater demand for network security in all sorts of areas such as users, devices, the cloud, and the corporate network. Without the security, the other pieces of the puzzle cannot work as intended. Any one of these trends would be disruptive but having them all occur at the same time is transformative at a minimum, in our view, and could impact society as much as the Model T, airplane, radio, large scale electric power distribution, and air conditioning did in the first few decades of the 20th Century.

Looking forward, we remain optimistic with regard to our strategy. We are focused on the Biden administration's infrastructure spending bill, which could result in trillions of dollars flowing into areas such as renewable energy, broadband internet and 5G – areas where PLUS has material exposure. We believe that the market is beginning to position for such a catalyst as evidenced by recent strength in our Data Centers and 5G category. Cell tower REITS, for example, were among our worst performers in 2020 but as of today are flat or green since inception.

Infrastructure PLUS Performance

Infrastructure PLUS reported a total return of 1.4% for the first quarter of 2021 which lagged both the S&P 500 (+6.2%) and the Dow Jones Brookfield US Infrastructure Index (+8.7%). Since inception (4/30/2020), the strategy has returned 43.1% which compares favorably to the S&P 500 (+38.6%) and the Dow Jones Brookfield US Infrastructure Index (+14.4%).

PLUS's best performers during the quarter included rail operator Kansas City Southern (KSU, 29.3%), who entered into a $25 billion merger agreement (implying $275 per KSU share) with Canadian Pacific Railway (CP) in March. CP's bid on KSU was then topped in April by Canadian National (CNI) who offered a cash and stock merger valuing KSU at $325/share. KSU's board is reviewing both bids, but it is likely that CNI's represents the superior outstanding offer. Quanta Services (PWR) was up 22.2% during the quarter as the company stands to benefit from proposed federal infrastructure spending to modernize the power grid. PLUS also took a position in cybersecurity player Fortinet, Inc (FTNT) early in the first quarter. The stock was up 22.7% from the date of our purchase on strong FY2020 earning results and above-consensus 2021 guidance.

Laggards during the quarter included renewable energy players such as Array Technologies (ARRY, -30.9%), who was partly a victim of the market's move into cyclical stocks and away from higher growth technology stocks, but also has been facing margin concerns due to the solar tracker market becoming more competitive. Other laggards include renewable energy project developer Brookfield Renewable (BEPC, -19.7%) and residential solar installer SunRun (RUN, -12.8%).

Best performers from PLUS's 4/30/20 inception through the end of the first quarter of 2021 include solar inverter duopoly Enphase Energy (ENPH, +213.7%) and SolarEdge (SEDG, +153.2%) as well as solar installer SunRun (RUN +171%). Worst performers from inception were Array Technologies (ARRY, -39%), electric power generator Vistra Energy (VST, -13%) and semiconductor manufacturer Broadcom, Inc (AVGO, -4.1%).

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