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Table with 6 columns: Jeffrey Rubin, Avery Shenfeld, Benjamin Tal, Peter Buchanan, Warren Lovely, David Bezic. Each column contains a name and a phone number.

Infrastructure: The New Frontier

Benjamin Tal

Randomly choose almost any point in time during the past five years and you will find that investment in global infrastructure portfolios outperformed investment in global equities, while still paying more in dividends and experiencing lower volatility.

What is Infrastructure?

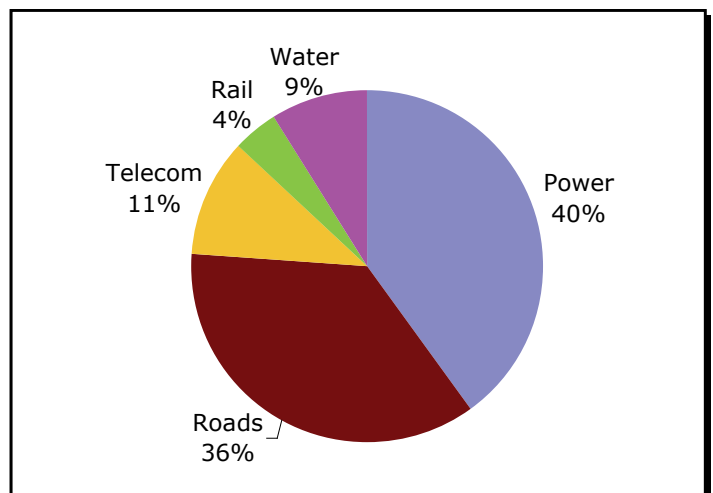
Here our focus is on economic infrastructure assets such as transportation, distributions and communications as opposed to social infrastructure (schools, hospitals). Infrastructure assets typically possess some type of monopolistic or quasi-monopolistic market position.

The World Bank estimates the total global value of infrastructure investment at roughly \$17 trillion. The actual number is probably higher as the estimate does not include ports, airports and oil & gas infrastructure.

The Infrastructure Deficit

Decades of underinvestment have resulted in crumbling infrastructure systems in North America. In a recent assessment, the American Society of Civil Engineers assigned an average grade of "D" to America's infrastructure facilities.

Chart 1 The Global Infrastructure Market

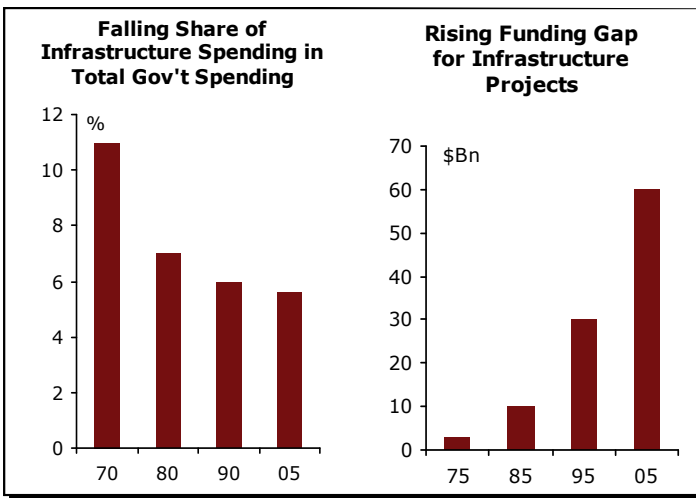


Source: World Bank, CIBCWM

vehicle miles travelled, but the total highway mileage has increased by only 1%. And it will take roughly \$180 billion a year just to maintain the nation's 50-year-old highway system. Ditto the rail network system that today carries 40% more than the volume it did in 1980, despite a 35% reduction in available track mileage. No less than \$1.6 trillion is needed over the next five years to restore conditions of the country's infrastructure system as a whole to acceptable levels.

In Canada, the situation is not much different. Nearly 60% of Canada's infrastructure is between 50 and 150 years old, and more than half of the systems have reached 80% of their service life. Government spending on infrastructure as a share of total spending has declined dramatically over the past three decades, while the share of public infrastructure capital relative to overall capital stock slipped by more than a third. The result: a ballooning infrastructure deficit, which is now rising at a rate of two billion dollars a year to reach an estimated size of more than \$60 billion (Chart 2).

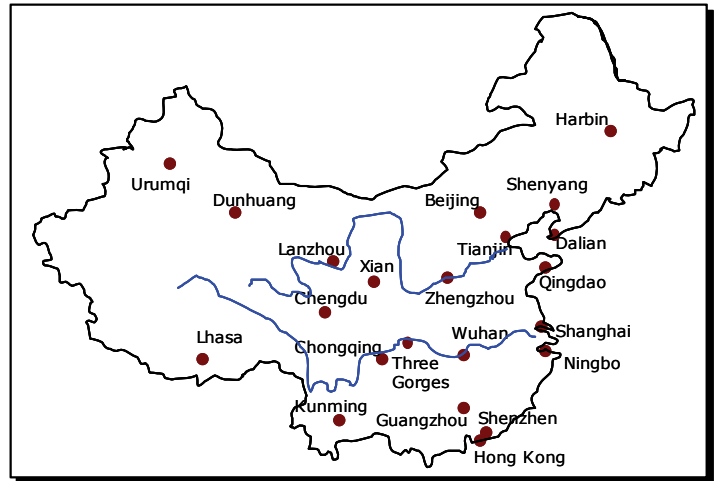
Chart 2
The Rise of the Infrastructure Deficit in Canada



Source: StatCanada, Infrastructure Canada, CCPPP, CIBCWM

The situation in the developing world is even more challenging. China, already home to nine of the world's top 50 ports, will invest some \$50 billion in additional port infrastructure in the next five years, while no less than 22 new intermodal terminals are now being built around the country (Chart 3). In India, highways move

Chart 3
22 New Intermodal Terminals in China



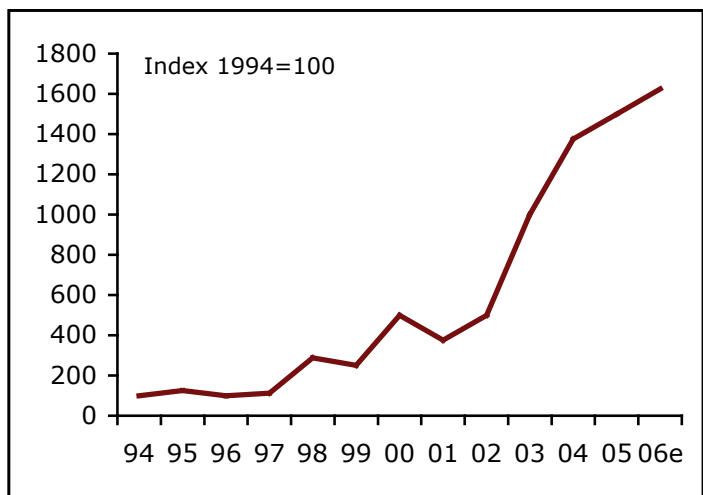
about 70% of goods transported, but still account for only 2% of the country's entire road system. And no less than one-third of the length of those highways is a single lane. Indian ports have a vessel turnaround time of 3-5 days, compared with only 4-6 hours in Singapore or Hong Kong. Increasingly, in both countries, governments appear to be more committed than ever in removing the red tape involved with infrastructure investment, and in paving the way for effective public-private partnerships (P3).

Closing The Infrastructure Gap

And that's precisely where the opportunities lie. As governments grow increasingly weary of playing catch-up with years of underspending, and become increasingly unwilling and unable to fund demand in infrastructure investment, private sector project financing is stepping in to fill the gap—attracting investors' interest at record levels into this emerging asset class, once considered the domain of municipal governments.

In the eurozone, the volume of private sector infrastructure investment (including P3s) has more than tripled over the past five years and is likely to rise even faster in the next five years—led by Germany and to a lesser extent France (Chart 4). Even the US, which traditionally has steered clear of private sector involvement in infrastructure investment, is slowly changing its colour, with states like California and Texas recently passing legislation

Chart 4
Private Sector Infrastructure Investment in the Eurozone



Source: CIBCWM based on Dealogic

allowing or encouraging P3s. What's more, mergers and acquisition activity in the global infrastructure market is already at a record high, with sub-sectors such as toll roads, gas & electricity, and transmissions & distribution leading the way (Chart 5).

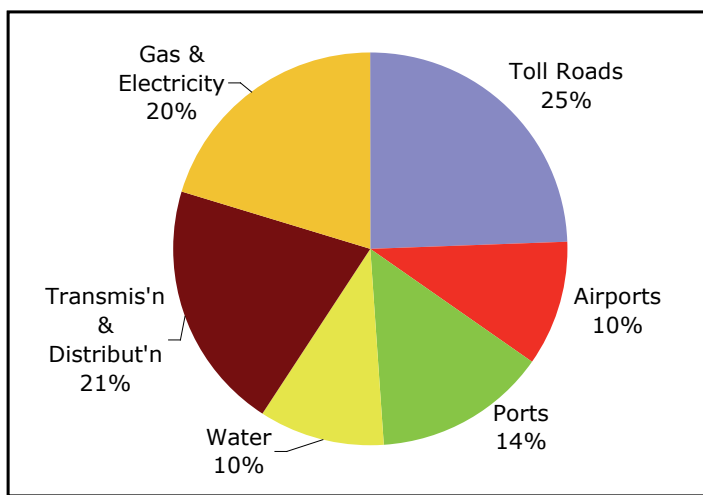
What makes investment in infrastructure particularly attractive at this time is that the rising supply of infrastructure projects coincides with a rapidly growing

demand for that kind of investment. Low interest rates, an aging population looking for defensive, high-yielding investments, and the growing need among pension funds to match long-term liabilities with stable long-term cash flow, all combine to boost valuations of infrastructure stocks both in North America and globally. Stability and predictability of returns are the key words here. The logic is that London Bridge may fall down, but only long after the next stock market crash.

And the numbers speak for themselves: since the beginning of the decade, global infrastructure portfolios consistently outpaced global equities indexes¹. In the past two years alone, listed global infrastructure stocks—led by toll roads, water, ports and communications—have delivered a dazzling 60% return, roughly 20 percentage points better than the return on the MSCI World Index. And all this was achieved despite a standard deviation 10% lower than that of the global equity benchmark (Chart 6). Not surprisingly, the market capitalization of the global infrastructure sector has recently surpassed the \$2.0 trillion mark—double the levels seen early in the decade (Chart 7). Yet, only 15% of infrastructure companies worldwide are listed—half the share seen in asset classes such as real estate. Look for this number to rise sharply in the coming years.

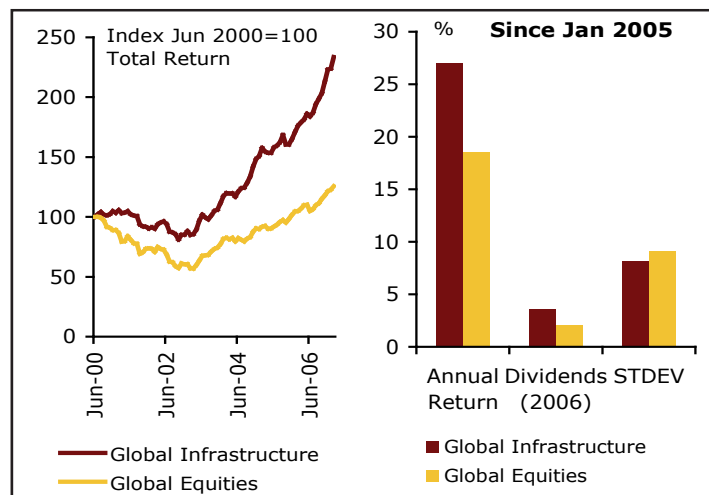
¹ We used the average of 4 global infrastructure indices: Lazard, UBS, Macquarie and S&P.

Chart 5
Distribution of Major Mergers & Acquisition Activity in Global Infrastructure (2004-2006)



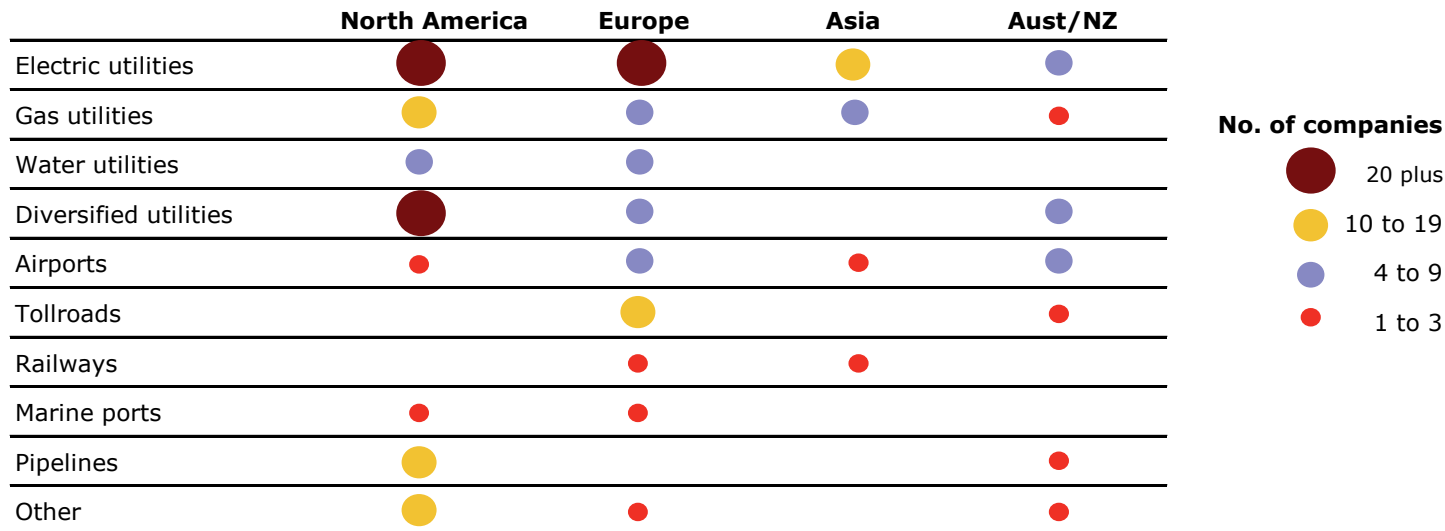
Source: CIBCWM, World Bank, RogersCasey

Chart 6
Investing in Infrastructure



Source: Lazard, UBS, Macquarie, FTSE, S&P

Chart 7
Listed Global Infrastructure Companies



Source: Lazard Asset Management Pacific Co.

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