Green Infrastructure Fund
Q3 2023 Commentary

Performance with principles®

PERFORMANCE

	3 Months	6 Months	1 Year	ITD*
Fund Performance (B Class)	-5.8%	-11.7%	-13.9%	-11.0%
IA Infrastructure	-5.1%	-7.9%	-8.5%	-11.5%
Sector Quartile	3	4	4	3

Source: Morningstar. Figures compared on a Bid to Bid basis with Net Income Reinvested. *Inception: 28 September 2022

MARKET REVIEW

The third quarter of 2023 was characterised by a continuation of the trends seen in the second quarter with infrastructure share prices declining amid concerns about high government bond yields. This continued to draw investors away from what they previously viewed as bond proxies (e.g. infrastructure) and towards risk-free government bonds. We believe this is the wrong way to view infrastructure, as it fails to take into account the high levels of inflation-linkage present in infrastructure revenues. Those government bonds that are inflation-linked have been trading at yields much below those offered by infrastructure. While share prices have disappointed, the underlying asset prices of our investments have remained broadly stable, and the income delivered has compensated investors for inflation.

PERFORMANCE & ACTIVITY

The end of this quarter marks the EdenTree Green Infrastructure Fund's first full year. A consistent theme over this period has been that, although the fund has not been immune to falling share prices, we believe the fund has avoided the deepest drawdowns experienced by some of the other funds that focus on clean energy generation. We believe part of this is due to stock selection, and part of it is due to our active approach to diversification.

The fund declined over the quarter, as did the broader infrastructure sector. Generally we saw non-green infrastructure outperforming green infrastructure. Nevertheless, we were pleased to see that, despite never compromising on our green investment approach, the fund delivered performance more aligned with the non-green segment of the global infrastructure sector. Once again, the complementary assets portion of the fund outperformed the rest of the fund. A noteworthy outperformer in this segment was Target Healthcare REIT, which benefitted from signs of rental growth from a care home sector that is still slowly recovering from the pandemic.

Among the quarter's worst performers were Harmony Energy Income Trust and Gore Street Energy Storage Fund. Both of these may have been responding negatively to signs of lower revenue potential for energy storage in UK markets. When it comes to Gore Street, such a response fails to take into account the broad diversification of their portfolio outside of the UK into markets with different dynamics, such as Texas. In both cases, we believe these companies are likely to benefit from valuation uplift as their assets under construction start generating cash flows.

One of the primary objectives of the fund is to provide investors access to the characteristics of the infrastructure asset class, such as low volatility and low correlation to equity and fixed income markets. Nevertheless, because we invest in publicly listed infrastructure assets, equity price movements can introduce volatility that is not present in the underlying asset prices. To combat this, we are able to hold complementary assets in the fund, which we can use to reintroduce some of the desired stability of the fund during times when our core equity infrastructure holdings are unusually volatile. This is clearly such a time and, as such, we increased our allocation to short-dated Aaa-rated supranational green bonds over the period.

Due to being short-dated, their pull-to-par effect tends to overwhelm correlation to fixed income markets more broadly, and these holdings represent debt funding of global green infrastructure projects, clearly furthering the fund's green objectives.

News relating to positive environmental outcomes from our holdings included the following:

- Gore Street Energy Storage published its ESG and Sustainability Report during the period under review, in which it states that its operational assets avoided 3,590 tCO_2e and stored 9,055MWh of renewable electricity over the year. We visited Gore Street Energy Storage's Stony site after period end.
- Bluefield Solar Income Fund released its annual results, in which the company stated it had generated 836 GWh of electricity over the period from solar and wind generation, equivalent to replacing 200m litres of petrol if used to power electric cars. We visited the Rookwood Solar Farm after period end and met with several Bluefield representatives.
- Target Healthcare REIT published its annual report (after period end) in which it stated that 94% of its care homes are EPC A & B Rated, as opposed to just 58% for the average of listed peer portfolios. We met with the company management after period end.

OUTLOOK

Looking at the history of the broader infrastructure universe, discounts to NAV are now significantly wider than they were heading into 2017 UK elections, when there were concerns that a Corbyn government would nationalise UK infrastructure; they are wider than they were at the deepest depths of the pandemic; and they are at least equal to where they were during the global financial crisis of 2008/09. Confounding such pessimistic valuations are infrastructure assets that not only are performing well and generating strong cash flows but that are in some cases being sold in private market transactions at prices that give strong confidence around NAVs. For example, TRIG (holding) announced during the quarter that it had exchanged contracts to sell three wind farms to Statkraft for €25m, representing a 26% premium to the valuation as at 31st December 2022. These are older onshore wind farms nearing the end of their expected lives, with the valuation uplift representing development value from life extension and repowering, which, conservatively is not included in valuations. Yet TRIG itself continued to trade on a material discount to NAV. History has shown that, over the long term, total returns to equity infrastructure investors tends to converge towards underlying NAV total returns. Given the aforementioned evidence of resilience in NAVs from recent transactions in underlying assets, we find it likely that this convergence will happen through share prices rising towards NAV levels rather than through NAVs declining dramatically from here. In the meantime, our holdings continue to generate inflation-mitigating income for our investors through activities which generate positive environmental outcomes.