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# INFRASTRUCTURE INVESTING AGAINST A BACKDROP OF RISING RATES

Global Infrastructure Dividend  
Focus Equity Team

July 2022

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# US CPI HITS 7.5%...THE HIGHEST READ SINCE 1982! EURO-AREA INFLATION RECORDS A FRESH HIGH OF 5.1% IN JANUARY 2022!

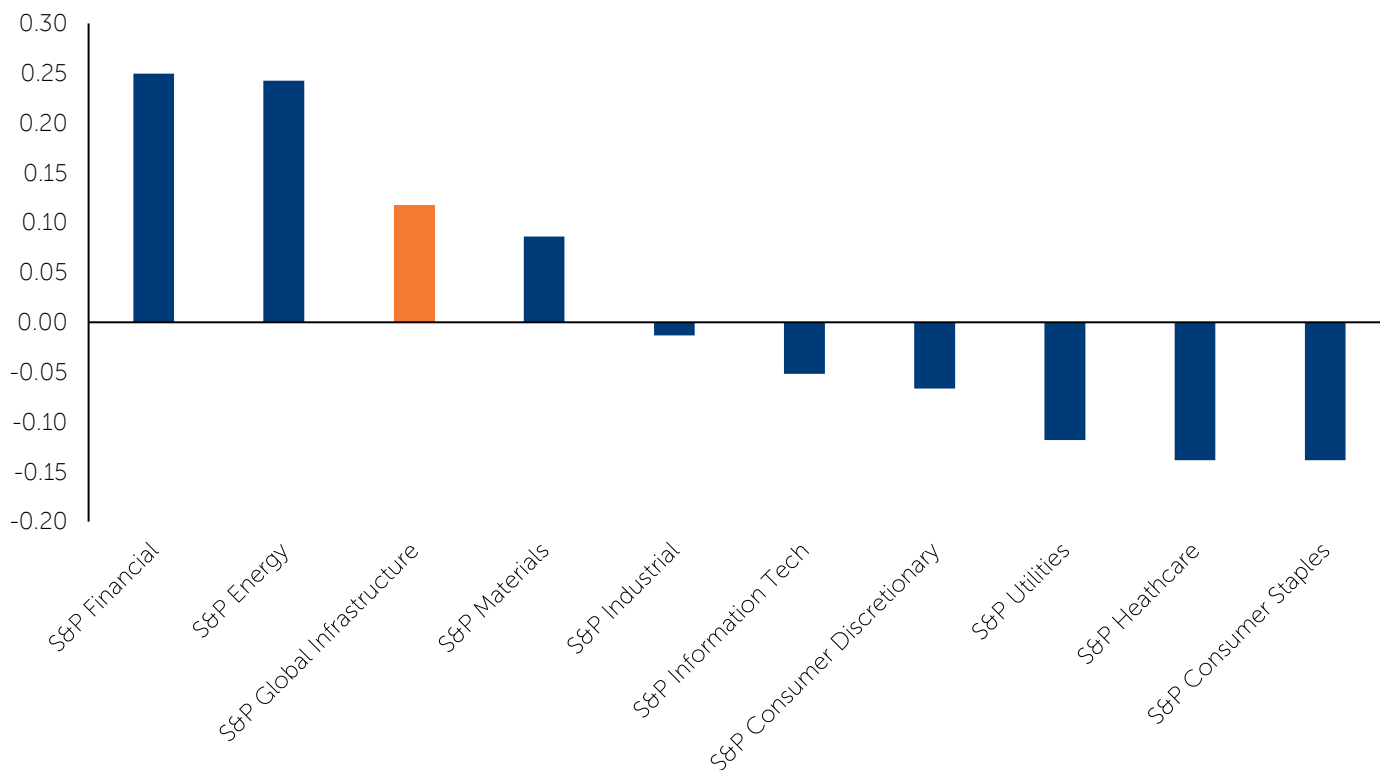
After over a decade of ultra-low/zero interest rates and disinflationary trends, persistent above-trend inflation is almost unfathomable. For the first time in years, allocators are dusting off the playbook for how to navigate a potentially new market paradigm. While equities are a natural starting point, not all equities are equipped to handle such an environment. We believe listed infrastructure equities fit the bill.

Most business models within the infrastructure space have mechanisms in place to pass through inflationary pressures. Utilities generally have clearly defined regulatory paths to allow for adjustments during periods of inflation. Energy pipelines and many health care real-estate investment trust (REIT) contracts similarly have CPI-adjustment clauses that allow revenue to rise along with costs. Toll roads and airports have it even better; with consumer price index (CPI)-adjustment clauses in their contracts and an established fixed-cost base, many of these businesses will see higher revenues and little change to their cost structures in a rising rate environment. It is a misconception that these companies cannot perform well in a rising-rate environment.

In fact, the chart below reveals that the global infrastructure asset class is one of only a few areas of the market that are positively correlated to rising inflation expectations.

## Inflation Linkage

### Global Infrastructure Positively Correlated to Inflation Expectations



Source: Bloomberg. \*20 years as of 12/31/21

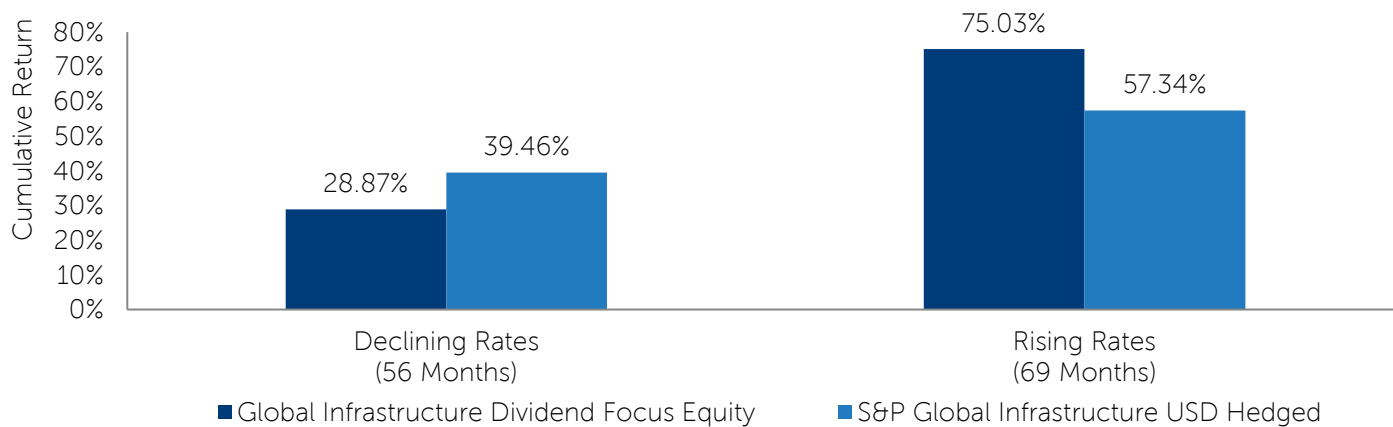
Investing in infrastructure involves an in-depth understanding of the levers these businesses possess to maintain, or even expand, earnings in the face of inflation. When analyzed properly, the hard assets underpinning infrastructure equities can provide a natural hedge in an inflationary environment.

Our Global Infrastructure Dividend Focus Equity strategy is managed with a goal of consistently maintaining a 6% dividend yield, which is between 2% to 3% higher than our peers and S&P Global Infrastructure index. This focus on equities with higher yields naturally concentrates our efforts on equities with lower duration, which are inherently less sensitive to interest rates. We believe our distinct focus on higher-yielding equities and maintaining balance with regard to interest-rate factors should position our strategy to perform well in a variety of interest-rate environments.

# The Proof

Over the ten-plus years of managing the strategy, we have produced positive absolute and relative returns in rising rate environments, while modestly lagging on a relative basis in a declining rate environment. This outcome reflects the intentional design of the strategy — stock selection should drive returns, with neutral positioning (to the extent possible) relative to measurable macroeconomic factors, including interest rates. The chart below details our history of absolute and relative returns in months where rates are either rising or falling.

## Cumulative Returns in Rising and Declining Interest-Rate Environments



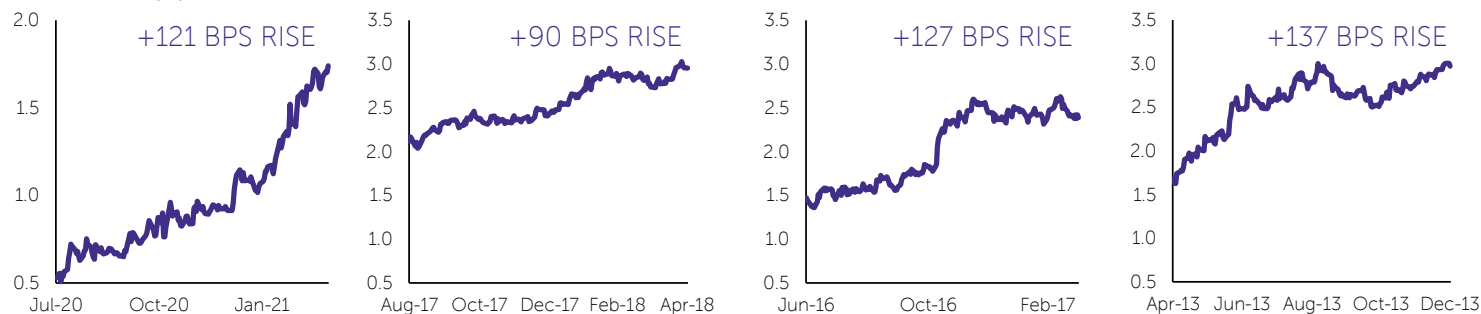
Source: eVestment, as of December 31, 2021. PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested. The performance results shown are [gross and] net of investment management fees and do reflect the reinvestment of dividends and other earnings. Performance presented for the measurement period from February 1, 2018 to September 1, 2021 represents the performance of the strategy when managed at Mellon Investments Corporation ("Mellon"), an affiliate of NIMNA Performance presented for measurement periods prior to February 1, 2018 represents the performance of the strategy when managed at a prior affiliated firm. \*Based on the monthly movements of the US 10 Year Treasury Yield. Periods of no movement not included. Performance is expressed in U.S. dollars. See Additional Information in Disclosure Statements.

Averages can mask volatility, and investors are often most concerned with the extremes. Since the inception of the strategy, we have seen a fair amount of interest-rate volatility, but four periods stand out in particular.

## Absolute Returns in Rising-Rate Environments

Strategy	Rank	Returns (%) <sup>*</sup> 8/1/20 - 3/31/21	Rank	Returns (%) <sup>*</sup> 9/1/17 - 4/30/18	Rank	Returns (%) <sup>*</sup> 7/1/16 - 3/31/17	Rank	Returns (%) <sup>*</sup> 5/1/13 - 12/31/13
<b>Newton Investment Management</b>	<b>2</b>	<b>13.50</b>	<b>1</b>	<b>1.91</b>	<b>2</b>	<b>6.41</b>	<b>2</b>	<b>7.92</b>
Manager 1	7	8.96	8	-5.87	8	0.47		---
Manager 2	6	9.59	3	-1.24	6	3.74	6	4.31
Manager 3	3	11.40	4	-1.98	4	4.33	3	6.88
Manager 4	1	15.27	5	-2.98	3	6.18	5	4.57
Manager 5	8	7.46	6	-4.36	7	0.49	7	0.15
Manager 6	5	10.35	7	-4.72	5	3.98	4	5.48
Manager 7	4	10.61	2	0.89	1	16.96	1	11.75

## US 10Y Yield (%)



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By virtue of our expanded 500-stock opportunity set, we can invest in infrastructure securities that we believe can weather, or even outperform, broad equity markets during rising-rate environments

First, 2013's Taper Tantrum sparked an eight-month period<sup>1</sup> when the US 10-year Treasury rose 137 basis points (bps) and bond proxies sold off in sympathy. Given our consistent focus on maintaining balance in the strategies, we were up 7.9% (net of fees) in absolute terms over that period, generating the second-best performance versus seven of our largest listed global infrastructure peers.<sup>2</sup>

The second material spike in the US 10-year Treasury unfolded between June 2016 and March 2017, when the yield rose 127 bps. This period coincided with the unexpected victory of Donald Trump in the US presidential election and an aggressive pro-business policy shift related to corporate taxes. In this environment, the strategy notched the second-best outcome of the eight overall managers in the analysis, rising 6.4% (net of fees) in absolute terms.

The third period of interest-rate regime change began in September 2017. Over these eight months,<sup>3</sup> the US 10-year Treasury rose approximately 100 bps, with yields exceeding 3% for only the second time during the last decade. From September 2017 through April 2018, the strategy was up 1.9% (net of fees) in absolute terms versus the Index, which fell -3.7%. We emerged as the best-performing global infrastructure strategy against the peer group as detailed in the chart above. We believe this was owing to our ongoing focused discipline and balance within the portfolio.

The final period recently occurred from July 2020 through March 2021, when the US 10-Year Treasury rose approximately 121 bps from cycle lows of 0.5% during the lockdown phase of the Covid-19 pandemic. Our strategy delivered the second-best performance relative to the seven largest listed global infrastructure peers, rising 13.5% (net of fees) on an absolute basis. The burgeoning global recovery, coupled with rising inflationary trends, underpinned the dramatic shift away from low rate beneficiaries.

As we sit here today in June 2022, we're likely to be managing through another material rate increase following a more hawkish Federal Reserve and formally announced taper program, driven by persistent above-trend inflation.

## What Drives This Outcome?

Since the inception of the strategy, we have calculated a proprietary factor across our entire investable 500 stock universe that measures each company's sensitivity to changes in interest rates — effectively calculating each stock's "equity duration." We do not use this factor to express a view on the direction of interest rates; rather, we use it to control risk as we seek to ensure balance or neutrality to macro factors. We have consistently maintained this balance since inception, focusing our efforts on our core competency: assembling a portfolio of the best 30 infrastructure stocks from our 500-stock universe into a balanced higher-yielding portfolio.

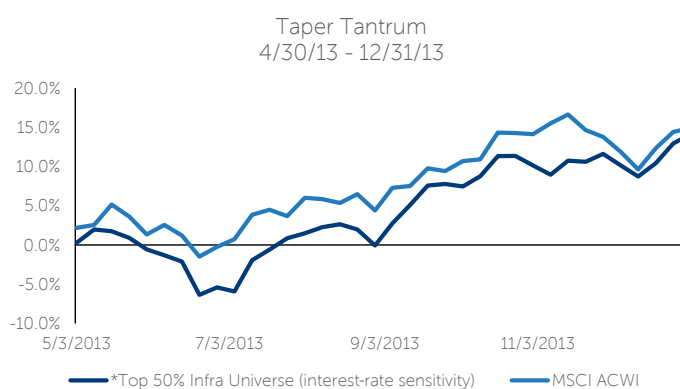
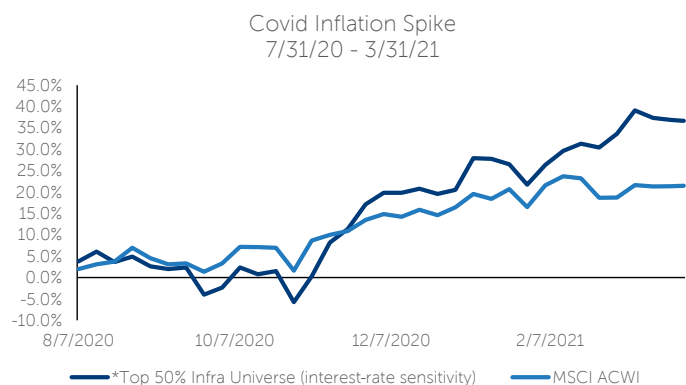
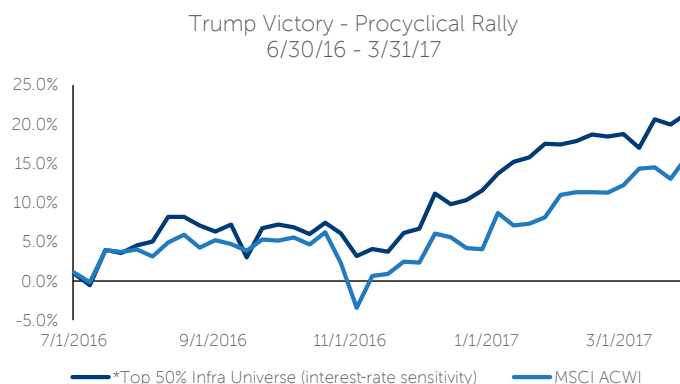
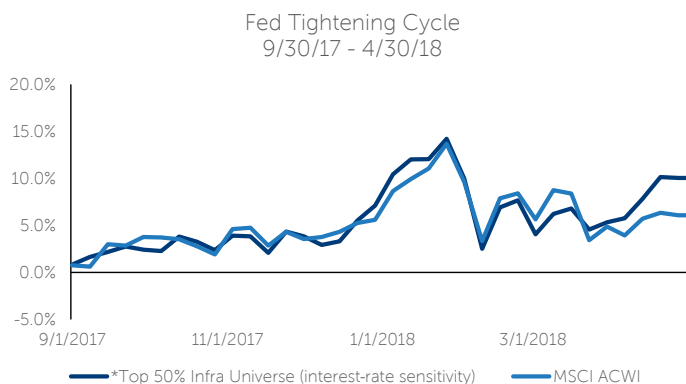
We believe predicting macro factors is a far more volatile pursuit, and one that few, if any, managers can consistently do well.

By virtue of our expanded 500-stock opportunity set, we can invest in infrastructure securities that we believe we can weather, or even outperform, broad equity markets during rising-rate environments. As a result, a key point of our investment process is to always have exposure to this mix of businesses.

The exhibit below demonstrates the performance of the half of our 500-stock universe with the lowest equity duration. Against this group, we plotted the performance of MSCI ACWI over the four most extreme interest-rate regime changes in recent history — the same four periods detailed above.

As expected, the global equity market performed quite well during each period. Surprisingly to some, the selected half of our universe (securities with lower equity duration) outpaced global equity markets in three of the four time frames, with the "taper tantrum" of 2013 a very slight lag. In reality, our investable universe has typically outperformed global equities in sharply rising-rate environments. These building blocks allow us to create a strategy that can perform in a variety of interest-rate environments.

## Infrastructure Equities Has Outperformed in Rising-Rate Environments



Source: Factset. As of March 2021. \*Top 50% Infra Universe (interest-rate sensitivity): The half of Newton's proprietary listed infrastructure investable universe more positively correlated to rising interest rates.

Midstream energy is an example of an industry that typically performs well when rates move up. Aside from the adjustment mechanisms tied to CPI within their contracts, there tends to be a natural link between interest rates and demand for pipelines. Broadly speaking, changes in interest rates follow inflation expectations, and inflation is particularly sensitive to robust commodity prices. Importantly, the price of commodities and the demand for pipelines are directly related. As higher commodity prices push inflation (and ultimately interest rates) higher, midstream companies usually also see a step change in demand. This is one of many infrastructure categories that had a natural link between interest rates and end-market demand.

## Conclusion

After a prolonged period of ultra-low global interest rates, conditions are beginning to change. Rates have moved higher over the last few months, and consensus has shifted to expect moderately higher rates over the coming years. Of course, investment managers and strategists will have a wide array of opinions on the future direction of inflation and interest rates.

We believe our solution largely neutralizes and negates the implied risks associated with bond-proxy-like business models that comprise a sub-segment of the global infrastructure asset class. Our focus on balancing both interest rates and consistent delivery of a 6% equity dividend yield through the cycle has allowed us to deliver positive absolute and relative performance results in the four most extreme periods of rising rates during our tenure. All the while, we have generated a very compelling outcome compared to our six most common peers.

## Global Infrastructure Dividend Focus Equity Composite

Year	Asset-weighted Gross	Asset-weighted Net	S&P® Global Infrastructure (USD) Hedged (ND)	Composite 3-Yr St Dev	Benchmark 3-Yr St Dev	Number of Portfolios	Composite Assets (\$mm)	Firm Assets (\$mm)	Composite Dispersion
2021	19.85	18.68	14.39	20.84	17.91	≤5	635	65,747	N/M
2020	-17.64	-18.48	-8.86	20.54	17.86	≤5	669	601,427	N/M
2019	22.47	21.27	26.92	8.16	8.43	≤5	957	534,173	N/M
2018	-1.98	-2.67	-6.29	8.83	7.95	≤5	826	488,649	N/M
2017	11.75	10.98	13.59	9.03	8.98	≤5	763	43,644	N/M
2016	11.65	10.88	13.28	9.79	8.91	≤5	420	38,096	N/M
2015	-2.86	-3.54	-7.38	9.98	9.27	≤5	344	36,610	N/M
2014	20.07	19.25	18.66	8.73	7.51	≤5	443	48,461	N/M
2013	19.45	18.63	15.37	N/A	N/A	≤5	210	47,589	N/M
2012	16.24	15.45	9.94	N/A	N/A	≤5	65	41,344	N/M

The Global Infrastructure Dividend Focus Equity composite measures the total return of all fee-paying, discretionary, equity portfolios that seek long term capital appreciation through investment in a diversified mix of listed equities, expected to be high yielding and issued by companies in infrastructure related sectors including but not limited to the following sectors - telecommunication services, utilities, energy, industrials and materials. These could include companies which provide services and facilities to support infrastructure development and those which may benefit from investment in infrastructure development. This is a concentrated strategy that currently targets to hold between 20 and 40 securities. Currency forward contracts are used to hedge currency risk back to USD. The use of derivatives is a characteristic of this investment strategy. Derivatives may be used to generate excess return, create long and short positions, as well as to manage risk. Minimum portfolio size for inclusion is \$1 million. The composite was created on August 31, 2011. The composite has an inception date of August 1, 2011. The performance of the composite is expressed in US Dollars. A list of composite descriptions and a list of limited distribution pooled fund descriptions are available upon request.

Newton Investment Management North America, LLC ("NIMNA" or the "Firm") is a registered investment adviser and subsidiary of The Bank of New York Mellon Corporation ("BNY Mellon"). The Firm was established in 2021, comprised of equity and multi-asset teams from an affiliate, Mellon Investments Corporation. The Firm is part of the group of affiliated companies that individually or collectively provide investment advisory services under the brand "Newton" or "Newton Investment Management" ("Newton"). Newton currently includes NIMNA and Newton Investment Management Ltd. ("NIM"). Performance is presented to show the performance of all fee-paying portfolios with substantially similar investment objectives, policies and strategies, which were managed at a prior firm affiliated with NIMNA until September 1, 2021. Performance results from the prior affiliated firms were linked on September 1, 2021 to the results achieved at NIMNA in compliance with the GIPS Guidance Statement on Performance Record Portability. Firm assets presented through September 1, 2021 represent the Firm assets of NIMNA prior affiliated firms which managed this investment strategy prior to the formation of NIMNA.

The composite's benchmark is the S&P® Global Infrastructure (USD) Hedged Index (Net). The S&P® Global Infrastructure (USD) Hedged Index is designed to track 75 companies from around the world chosen to represent the listed infrastructure industry while maintaining liquidity and tradability. To create diversified exposure, the index includes three distinct infrastructure clusters: energy, transportation, and utilities. The index hedges the foreign currency exposure of investments to the US dollar. The composite's benchmark was changed retroactively on September 30, 2017. The benchmark was changed from the custom Global Infrastructure Hedged USD Index (Gross) in an effort to use a similarly structured, non-proprietary index made available by S&P® Dow Jones Indices, as well as to more closely align the strategy's potential total returns with those of the net benchmark given the variations that can occur in the tax withholding rate. Composite performance is net of non-reclaimable withholding taxes on dividends, interest income and capital gains where applicable. Some composite participants may use different sources of foreign exchange rates from other participants and the composite's benchmark.

The standard management fee for this strategy is: 0.70% of assets on the first \$25 million, 0.60% of assets on the next \$25 million, 0.50% of assets on the next \$50 million, and 0.35% on assets thereafter. Net-of-fee returns are calculated using model fees which are equivalent to the standard fee schedule for each investment strategy. Composites containing broad distribution pooled funds apply a model fee equivalent to the investment management portion of the fund's total expense ratio. Fees are accrued monthly for each account according to their assets under management and the results are asset-weighted to arrive at the composite net-of-fee return. Prior to January 1, 2019 net-of-fee returns were calculated by subtracting the highest tier management fee for the strategy from the gross returns on a monthly basis. Additional information regarding historical net-of-fee returns calculation is available upon request.

Gross performance figures are time-weighted rates of return, which include the deduction of transaction costs. Performance results reflect the reinvestment of interest income and other earnings. Past performance is not an indication of future performance. Gross returns were used to calculate all risk measures presented in this GIPS Composite Report. Internal dispersion figures are an asset-weighted standard deviation of all portfolios that were included in the composite for the entire measurement period. Dispersion figures for years containing 5 or fewer Portfolios are considered Not Meaningful or "N/M". The composite track record lacks the required 36 months necessary for the three year annualized ex-post standard deviation where "N/A" is presented.

Newton Investment Management North America, LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Newton Investment Management North America, LLC has not been independently verified. The Global Infrastructure Dividend Focus Equity composite has been examined for the periods 2013 - 2015. The performance examination reports are available upon request. Newton Investment Management North America, LLC's predecessor firms all have been independently verified for the periods January 1, 2007 through December 31, 2020.

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Email: [info@newtonim.com](mailto:info@newtonim.com)

### Endnotes

<sup>1</sup>Between April 30, 2013 and December 31, 2013.

<sup>2</sup>eVestment, U.S. dollar, unhedged gross returns, as of April 30, 2018.

<sup>3</sup>Between September 1, 2017 and April 30, 2018.

### Important information

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