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# High hopes

**Why the infrastructure sector is coming of age for income-seeking investors....**

Update
07 March 2025

As Geoffrey Chaucer opined many centuries ago, all good things must (sadly) come to an end. After a stellar run from the Magnificent Seven and a spell of attractive yields fuelled by higher-for-longer rates, investors may now be considering whether it's time to reposition their portfolios to take advantage of a shifting market cycle.

While the gravy train isn't hitting the buffers just yet, current forecasts suggest it may well be slowing down. First up is a projected moderation in returns from US equities, with BlackRock forecasting an annualised return of just 5% over the next decade, raising concerns that the AI frenzy may have borrowed from future returns, as we saw after the bursting of the dot.com bubble.

Elevated interest rates have also provided a boon for income-seekers in recent years but with rate hikes reversing, the landscape is changing. Gilts are forecast to deliver a solid annualised return of 4% but the equity and bond market rout of 2022 underscored the vulnerability of relying solely on a traditional 60:40 portfolio.

For investors looking beyond traditional assets, direct lending offers the potential for higher yields than bonds and equities, with a forecast annualised return of 9% over the next decade, underpinned by their illiquidity premium.

Within this, private infrastructure debt offers attractive risk-adjusted returns and built-in inflation protection as returns are driven by contractual cash flows rather than market sentiment. This presents an opportunity to lock in high yields over the medium term while gaining exposure to a defensive asset class with robust downside protection.

## Coming of age

Infrastructure has matured significantly as an asset class over the last decade. Private equity infrastructure funds under management have grown by 17% annually since 2013, hitting almost $1.2 trillion in global assets under management, while private debt funds under management have expanded at an impressive annual rate of 27%, according to Preqin.

On the debt front, constrained fiscal capacity has led governments to rely on private capital to fund the necessary build-out and renewal of infrastructure. This has been further compounded by the decline in traditional bank lending to the sector following the global financial crisis.

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As a result, private equity funds and infrastructure companies have turned to private infrastructure debt, which typically yields between 9-12%, to optimise their capital structures and meet target returns.

## Why it pays to be active

Retail investors face barriers to accessing private infrastructure debt relative to publicly-traded bonds and equities. Moreover, it requires specialised expertise to structure, carry out due diligence and monitor complex deals, which can't be replicated by passive strategies.

For investors seeking active exposure to the sector, **Sequoia Economic Infrastructure Income (SEQI)** aims to provide equity-like returns and high cash dividends by offering private debt for infrastructure projects backed by tangible physical assets.

**High yield**

One of the standout features of SEQI is its high yield: the average portfolio yield (to maturity) is currently

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9.7% (as at 31/01/2025), well above its 7-8% target, thanks to strong asset selection and disciplined portfolio construction.

While the trust owns private assets, its net asset value (NAV) is externally valued by PwC on a monthly basis which should provide confidence in valuations.

In addition, while loans may be 'marked-to-market' over their life, this is a largely theoretical exercise, creating potential upside when loans 'pull-to-par' and revert to their original value at maturity. As my colleague recently noted, this represented a potential gain of 4% of NAV (as at 31/12/2024).

**Access to industry experts**

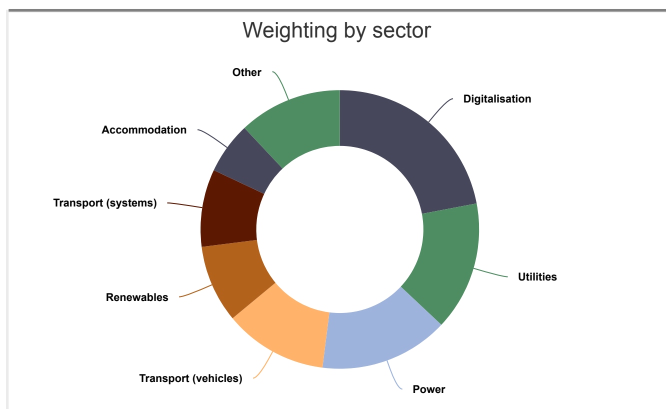
SEQI has a 20-plus investment team with a strong track record in origination, having made over 250 investments in the last nine years, including more than 100 in the US. This expertise enables SEQI to source high-quality deals, negotiate strong protections and proactively manage risks, ensuring resilience across economic cycles and changing market conditions.

While infrastructure debt generally features lower loss rates and higher recoveries than corporate credit, SEQI's team brings added security through their extensive experience in credit work-outs and restructuring, contributing to a below-average loss rate compared to broader corporate credit without the benefit of the defensiveness of infrastructure-related cash flows.

**Diversified portfolio**

SEQI provides investors with broad diversification across 10 high-quality OECD jurisdictions, 8 sectors and 40 infrastructure sub-sectors, as shown in the graph below, which differentiates it from peers concentrating on specific sectors such as onshore wind or healthcare.

**Fig.1: High-Level Of Sector Diversification**




Source: SEQI factsheet, based on portfolio allocation at 31/01/2025

This diversification allows the fund to be highly selective by targeting only the most attractive opportunities within each sector and maintaining low correlation between assets. By way of example, hydroelectric power, data centres and student accommodation each benefit from unique and distinct growth drivers.

With an average duration of less than four years, SEQI also recycles capital on a regular basis, keeping the portfolio fresh and enabling strategic allocation to high-growth markets while avoiding risks such as overcapacity in power sectors.

By maintaining a flexible and selective strategy, SEQI provides a well-balanced, resilient portfolio that captures growth across multiple infrastructure themes, ranging from replacing ageing transport and utility infrastructure to the expansion of emerging technologies.

**Harnessing mega-trends**

SEQI is also well-positioned to capitalise on strong structural growth drivers, including digitalisation and decarbonisation.

The rapid rise in AI and cloud computing power demand is driving an unprecedented requirement for hyperscale data centres, with Amazon, Alphabet and Microsoft alone committing to spend more than $250 billion on capital expenditure in 2025. As a result, data centres account for the largest sub-sector in SEQI's portfolio.

Another key growth driver is decarbonisation with the International Energy Agency (IEA) estimating that global clean energy investment will need to more than triple to $4 trillion per year by 2030.

SEQI's portfolio is well-positioned to capitalise on this soaring demand for clean energy infrastructure, with almost a quarter of the portfolio invested in renewables and power infrastructure, including natural gas generation which is expected to be required to balance out the variability of wind and solar in the decades ahead, on the back of the phasing out of coal-fired generation in many mature markets.

Other parts of SEQI's portfolio address additional investment priorities such as aging societies (healthcare diagnostics), urbanisation (rail) and education (student living). With government funding seemingly diverted towards social support and defence initiatives, there may be a sustained reliance on the private sector to provide funding for these themes.

## A decade of outperformance

SEQI's long-term track record is testament to the benefit of active management for investors looking for exposure to infrastructure debt. As the trust nears its 10-year anniversary, it has achieved a NAV total return of 77% since IPO, compared to a 37% total return for a global high-yield bond index (based on the iShares Global High Yield Corporate Bond GBP-hedged ETF, as at 31/01/2025).

In addition, the trust is currently trading on a discount of 18% to NAV (as at 03/03/2025), which could provide a kicker to returns if the discount narrows. As a result, this could present an attractive entry point for investors seeking exposure to a high cash yielding strategy with distinctly defensive diversification benefits in today's volatile economic environment.

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