

# THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

## Taking a Broad and Balanced Approach To Listed Infrastructure



**JAMES A. ABATE, MBA, CPA, CFA**, is the Chief Investment Officer of Centre Asset Management, LLC, and the Portfolio Manager of the firm's American Select Equity and Global Listed Infrastructure strategies. He also serves as the firm's Managing Director and as the President and Trustee of the Centre Funds. Prior to founding Centre Asset Management, Mr. Abate was Investment Director, North America, for GAM Investments. Prior to GAM, Mr. Abate served as Managing Director and Fund Manager/Head of U.S. Active Equity at Credit Suisse Asset Management responsible for its U.S. Select Equity Strategy and stable of Global Sector Funds. Mr. Abate has achieved Standard & Poor's Funds Research AAA rating, received numerous "Category King" mentions in *The Wall Street Journal*, is the

recipient of the Refinitiv Lipper Fund Award for Best U.S. Equity Fund, as well as multiyear *Investment Week* award nominations. Prior to transitioning to asset management, he was a Manager in Price Waterhouse's Valuation/Corporate Finance Group, and served as a commissioned officer in the U.S. Army and Reserves, achieving the rank of Captain. Mr. Abate holds a B.S. in accounting from Fairleigh Dickinson University, an MBA in finance from St. John's University, and is a visiting Adjunct Professor in the graduate and honors academic programs at the Zicklin School of Business, Baruch College. He is a contributing author to several John Wiley published books, *Applied Equity Valuation*, *Focus on Value*, *Short Selling* and *The Theory and Practice of Investment Management*; has written articles that have appeared in *The Journal of Portfolio Management*, *Investment Week*, *FT Investment Adviser*, *The Wall Street Journal* and *Mergers & Acquisitions*, among other publications; and his writings with Professor J. Grant, Ph.D., on the economic value added approach to security analysis have been adopted by the CFA Institute candidate study programs. Mr. Abate is a former member of the editorial advisory board of *The Journal of Portfolio Management*.

### SECTOR — GENERAL INVESTING

**TWST:** Please start by telling us about Centre Asset Management — your overall business and what defines or differentiates your overall philosophy and approach to investing.

**Mr. Abate:** We're a boutique firm. Our focus is on two equity strategies: American Select Equity (NASDAQ:DHAMX/DHANX) and Global Listed Infrastructure (NASDAQ:DHIVX/DHINX). We only manage the two strategies within fund form, so they're in '40 Act mutual funds available in the U.S. as well as in UCITS available to non-U.S. investors in the U.K., Europe and South Africa (Bloomberg: SACASCU and SACGLIC for American Select Equity and Global Infrastructure, respectively).

The UCITS are distributed by Sanlam, which is a major South African diversified financial services company that owns a minority 20% equity stake in Centre Asset Management. The rest of Centre's economic interest is owned by me as well as other day-to-day operating partners.

Centre operates its business wholly independent of Sanlam, but Sanlam does provide operational, compliance, and offshore distribution support, allowing us to focus more fully on managing funds rather than on some of the operational aspects of managing an investment management business.

Centre is designed to combine the benefits of a boutique, independently run entrepreneurial investment culture with the associated economies of scale from its large partner.

We always say that we don't want to spread ourselves too thin and, in very simple terms, I express to investors that we make vanilla and chocolate ice cream — American Select Equity and Global Infrastructure — in two wrappers: '40 Act mutual funds for U.S. investors, and pari-passu run UCITS funds for offshore investors. All we're trying to do each day is make the best vanilla and chocolate ice cream that we can.

What makes us different as an investment management firm is our concentration on only two truly active, high-conviction, and

research-intensive investment strategies. Each investment strategy aims to capitalize on defined market opportunities with consistent methodology and repeatable investment processes to achieve differentiated returns and risk profiles.

The common attribute in both strategies is a strong cognizance of not only long-term performance, but producing those returns with a high degree of risk awareness, particularly downside volatility. If you look at both the American Select Equity and the Global Infrastructure strategies, over time, you can see that the maximum drawdown figures as well as their downside volatility figures compare exceptionally favorably to their peer category funds.

From an investment process perspective, Centre's differentiation is our stock selection methodology, which is to implement the concept of economic value added — EVA; selecting companies that are creating shareholder wealth by making wise capital allocation and investment decisions.

I have applied EVA as a securities analyst during my long investment career with success and have been a leading champion of EVA in terms of written books, research papers, and the adoption of the concept by the CFA study program.

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As you can imagine, within infrastructure, because the businesses tend to be very capital intensive by nature, those capital allocation decisions relative to their returns vis-a-vis the cost of capital tend to be critically important.

Where we differentiate ourselves from the broader infrastructure peer funds category, aside from the EVA stock selection methodology, is our commitment on delivering a broad and balanced portfolio.

When you look at the infrastructure category — which is relatively new; it's only been a distinct Morningstar category for a few years now — a lot of the funds that have been grandfathered into that category were funds that were historically utility funds, or some other sector-specific fund like telecommunications or industrials.

Within the infrastructure category, you can see that there remains a very high concentration of exposure of most funds to the utility sector, as well as industrials with a subsector concentration in transportation industries.

Before founding Centre Asset Management, and prior to my work with GAM Investments, I was at Credit Suisse Asset Management. At Credit Suisse, I was the head of our flagship U.S. Select Equity strategy, but also was the firm's head of Global Sector Funds, which included a large stable of different funds ranging from technology to natural resources.

When objectively analyzing then and now, I never felt that any of the sector funds, per se, were really for the benefit of clients because they tended to be bought at inopportune moments — momentum tops — and tended to be not favorable on a long-term perspective due to the too-narrow thematic constraints, lack of persistence in generating excess returns, or the inability to offer some other consistently desirable

attribute for investors. So, despite my deep experience, Centre was very hesitant to launch a thematic fund.

With the positive sentiment on needed infrastructure investment in the U.S. coming into focus in 2016, as well as looking at what we thought was an opportunity to offer a genuine equity income product as an alternative for income seeking investors — bond yields were offering such paltry yields at that time — we felt that infrastructure was a fund category that we could bring a high degree of value-add to, through not only our differentiated security selection and risk awareness but also from a perspective of portfolio construction.

After “working in the lab” for a couple of years developing the strategy, we launched our Centre Global Infrastructure Fund in 2018.

With our Centre Global Infrastructure Fund, a key differentiating part of the investment process is to combine an active stock selection approach that invests in what we deem the most attractive infrastructure companies from the U.S. and developed international economies, and then balance the portfolio across all the major infrastructure sectors, namely telecommunications, energy, utilities, transportation, as well as social infrastructure including industries like health care and hospitals. **HCA Healthcare** (NYSE:HCA), for example, is a name that's featured within the portfolio.

We believe that we're one of the only funds within the infrastructure category universe that takes this truly diversified approach towards all the contributing sectors and industries of the infrastructure space.

**1-Year Daily Chart of Williams Companies Inc.**



Chart provided by [www.BigCharts.com](http://www.BigCharts.com)

The other differentiating attribute — and this relates to the point made about listed infrastructure companies being an alternative to municipal bonds and other fixed income investments that historically were used for project financing — is the ability of our fund to offer a stable and attractive distribution yield.

We're the only fund, as far as we're aware, within the infrastructure category that pays out a monthly income distribution to our shareholders.

As of June 30, 2023, the underlying yield of the portfolio stands at around 4.3%, which is attractive, particularly because of the lower tax rate benefit investors get due to the qualification of most dividends.

With infrastructure, we can offer an income distribution on a monthly basis akin to what a bond fund typically does, which certain income seeking investors, especially retirees, depend upon.

Also, because of the nature of the underlying assets of most infrastructure companies, there is a natural inflation hedge of the assets which are generating the free cash flow, which is funding the dividend, which is obviously not what a bond fund offers, as was very evident by the significant capital losses incurred by most bond fund investors during 2022, while most infrastructure funds protected capital relatively well.

**TWST: You mentioned the kinds of infrastructure sectors that you invest in. What about markets?**

**Mr. Abate:** We have a broad mandate to invest globally. One of the limitations that we place on the fund, by prospectus, is to limit the U.S. to no more than 60% of the fund's exposure, ensuring that we have geographic diversification across other developed markets.

**“This all highlights to us that right now, the traditional listed companies which are the industrial backbone of most developed markets — power generation, telecommunications, social infrastructure, energy transmission, etc. — are set to capitalize on improved pricing as demand has outpaced existing capacity.”**

Despite having a limited ability to, we don't venture very much into emerging markets. We tend to stick within the developed markets because that's where we think the opportunity is.

One irony, which is quite perplexing to us having trained originally as a valuation specialist, and this has been in place for quite some time, is the distortion in the infrastructure investment universe. What I mean by that is publicly traded or listed infrastructure, like the underlying investments in our fund, in developed markets, are relatively inexpensive — and I would say by a significant amount — when you compare that to the valuation multiples that are being paid for private transactions in the infrastructure space within developed markets.

In valuation finance, it's abnormal to see a discount for stocks with ready marketability versus private investments. This is being driven by the tremendous amount of pension investment capital that's gone into unlisted infrastructure, and this is despite the fact that unlisted infrastructure not only has a lack of liquidity, but usually a lack of control, and many other attributes, which all should be contributing factors to a discount rather than a premium in terms of valuation for unlisted investments.

Alternatively, emerging market infrastructure transactions, even in the listed space, are trading at relatively historically rich valuations. Furthermore, the need for infrastructure investment in emerging markets is now lower, proportionally, than in developed markets such as in the U.S. and U.K., where infrastructure investment has been severely neglected for several decades, while emerging markets, e.g., China, have invested heavily over the past two decades.

This all highlights to us that right now, the traditional listed companies which are the industrial backbone of most developed markets — power generation, telecommunications, social infrastructure, energy

transmission, etc. — are set to capitalize on improved pricing as demand has outpaced existing capacity.

Aside from the potential margin improvements from better pricing and growth initiatives, the underlying price-to-cash flow multiple on the fund is around 6.6 times, which is incredibly attractive when you compare that to broad market indices, whether it's the S&P 500 or, more appropriately, MSCI World. So, not only is the yield attractive relative to bonds, but the valuations versus other equities are attractive.

Getting back to geographic diversification, the fund has underlying investments in 12 different countries, including Japan, Spain, Australia, New Zealand, even Singapore. Again, we think the opportunity for listed, developed market infrastructure is quite compelling from an income and capital appreciation perspective, whilst maintaining an inflation hedge perspective.

One last point I want to raise in terms of where infrastructure can fit within an investors' overall portfolio mix, aside from being a straight complement to traditional assets or a potential alternative to fixed income, is on a style box mapping basis.

We hear a lot now of market participants being flummoxed by the investment decision between value and growth styles. We always point out to investors that are cognizant of this value versus growth style box differentiation, and may be top-down in their allocation orientation, that the problem with most value indices is that they tend to be very heavily influenced by the weighting of the financial services sector.

**1-Year Daily Chart of ONEOK, Inc.**



Chart provided by [www.BigCharts.com](http://www.BigCharts.com)

The financial services sector in the U.S. and Europe, in particular, has been a very disappointing area of investment for the last two decades, and subject to a great degree of risks without a commensurate return.

We've been telling investors that if you're value in your style orientation or want to tactically tilt that way, infrastructure and, in

particular, the way we manage infrastructure with regard to its diversified characteristics across all the infrastructure segments, brings forth a way to capture the value style investment theme without the drag or anchor of a heavy concentration in financial services, which has been and we think will continue to be an impediment to long-term relative value index performance versus growth.

**TWST: At the end of the first quarter, of the Centre Global Infrastructure Fund's top 10 holdings, six were energy and/or utility companies. Would you say that's typical? And how do you determine weightings among the different segments that are included in infrastructure?**

**Mr. Abate:** Once we've identified the stocks that we want to own, we go into our portfolio construction process with a very disciplined approach. That is, after meeting our geographic exposure requirements, we want the fund to be balanced: telecommunications should be about a third, utilities would be a third, and then energy, transportation, technology, and social infrastructure representing the remaining third.

**“From our perspective, this is a company with a substantial renewables pipeline, with a continuing legacy fossil fuel business that is becoming even more profitable, and one that is well geared towards the changing environment in power generation globally, and is taking advantage of its dynamism.”**

From that perspective, that's how position sizes are done. It's a combination of what we believe is the alpha opportunity in the individual stocks, the diversification constraints that we have with regard to geographic and sector exposures, and then analyzing the volatility contribution of each of the individual names within the portfolio.

**TWST: Can you tell us about a few stock examples, whether they're top 10 holdings and/or perhaps newer investment ideas that you're adding to the portfolio?**

**Mr. Abate:** One of the names that we've been recently adding to is **Enel SpA** (OTCMKTS:ENLAY) in Italy. This is a company that's been part of the portfolio for a while but we've continued to add to our position size as the opportunity has leaned more favorably. The stock now represents tremendous value to us at a 6.4% dividend yield.

The company is doing an excellent job in smoothly transitioning itself with regards to a complete coal exit by 2027. Half of its capital expenditures — capex — budget is geared towards renewables, but, at the same time, its fossil fuel business is highly profitable. The core business continues to be in Italy, the Iberian Peninsula, as well as Latin America.

From our perspective, this is a company with a substantial renewables pipeline, with a continuing legacy fossil fuel business that is becoming even more profitable, and one that is well geared towards the changing environment in power generation globally, and is taking advantage of its dynamism.

Another name that we like is **Mercury NZ** (OTCMKTS:MGHTF) in New Zealand. This is a new name for us added to the portfolio. It's an excellent business in that it's broad-based in its power generation from hydro to biofuels, with a near-monopoly type status — a very significant moat — with regard to its business.

That moat aspect is really key and shared by most of these power generation businesses, not just **Mercury**, because of the regulatory environment, and even those that are operating within the unregulated markets here in the U.S. as well as Europe, because of the significant capital intensity creating significant barriers to entry.

Furthermore, power generation investment is timely as we're seeing an inflection point in profitability as natural gas prices have stabilized at lower prices.

The other area that I'd like to highlight is that we continue to be big believers in the income and capital appreciation opportunities in oil and gas pipelines and storage in the U.S.: **Kinder Morgan** (NYSE:KMI), **Williams** (NYSE:WMB), and **ONEOK** (NYSE:OKE).

When you look at natural gas pipelines in particular, and the fee growth generation of these companies in relation to the regulatory burden of trying to build any new capacity expansions or new pipelines in the U.S., which is just so crippling — these companies have, in essence, given themselves a very wide moat to competition.

Also, people underestimate the importance of Europe as an export market for natural gas. Because we had such a mild winter last year, there's an incredible complacency in place in that we didn't get the same kind of volume impact to growth from the export of liquefied natural gas to Europe after the destruction of Nord Stream last year.

The growth in liquefied natural gas is significant and is allowing these companies to be part of that transportation growth process.

**1-Year Daily Chart of Exxon Mobil Corp.**



Chart provided by [www.BigCharts.com](http://www.BigCharts.com)

If you look at the dividend yield of these pipeline companies, all are near or in excess of 6%. From our perspective, all three of these companies represent exceptional opportunity, both from an income and a capital appreciation potential, driven by opportunistic and sustainable growth.

Many of these stocks had a significant drawdown in 2020, as most of the energy sector did, which had a shake-out of most non-energy-related investors. However, you're starting to see a continuation in a lot of the attributes that even generalist investors find attractive in the stocks, in terms of growth and stability of fee income, as well as distributions adding to their appeal.

**TWST: In terms of broad themes or trends within the energy infrastructure space, what are the most important in your opinion?**

**Mr. Abate:** Developed countries such as the U.S. have underinvested tremendously over the last decade in tangible, long-lived assets broadly. One of the points that we've consistently raised is, if you look at the excesses of investment over the previous decade, it has largely been in intangible assets, not in tangible assets.

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For example, the capital spending-to-depreciation ratio of the energy sector as a whole, which includes the major energy stocks, has historically seen a spending ratio approximately 150% of capex relative to depreciation over the long term.

At the trough of this recent cycle, it was down to below 50% for most of these companies. **Exxon** (NYSE:XOM) is just now back to spending, in terms of capital expenditures, an amount equal to its depreciation on a 12-month moving basis.

Remember, we had material underinvestment cycles, caused by the overinvestment cycles that preceded them. The first overinvestment period occurred starting in 2002 through to 2008, which was met with the global financial crisis, but then reaccelerated from 2010 through 2015, followed then by the big commodity price collapse.

Before things began reaccelerating in a meaningful way again, COVID brought the world to a halt, leading to a once-in-a-generation collapse in commodity prices.

Energy, mining, power generation and transmission investment cycles were met with back-to-back-to-back recessionary events, leading to sharp capex curtailments, which has had a profound impact on company management and boards of directors regarding investment.

That's why this is a more durable cycle, in my opinion, in terms of the stability and growth of cash flows for companies that are in the energy space.

Another name which we find attractive is **Flowserve** (NYSE:FLS), in the industrial space. They're in the flow control business, mainly geared towards working with the oil and gas industry in terms of flow control equipment, pumps, and things along those lines.

Here is a company that was literally decimated in terms of order cancellations from its customer base for almost a decade, but now you're finally starting to see the company get up off of the mat as capital spending budgets tick up in a stable and steady manner, rather than the boom/bust mentality so long associated with the energy industry.

The sales conversion of backlog for companies like **Flowserve** is much lower risk than historically, so it lays a future of opportunity, of economies of scale, that we think is quite substantial, both in terms of revenue growth and, as I mentioned, operating leverage, as these companies continue to harvest literally eight or 10 years of de minimis investment in both new transmission and production of fossil fuels here in the U.S.

This malinvestment period in intangibles saw a lot of the froth come off in 2022. Whether it's in Bitcoin production, redundant software-as-a-service features, or some non-fungible tokens of apes or some other nonsense like that, whatever else you want to think about in terms of what people wasted money on — the reality is we're probably looking at a period of shortages or tightness in supply for quite a period of time in tangible assets capacity.

Tightness in energy, food production, etc. — across the board basically — is something that will likely keep inflation stickier for longer, which by its nature is something that will have investors gravitate towards companies that are cash generating, particularly those that have natural inflation hedges in their asset bases such as infrastructure.

**1-Year Daily Chart of Flowserve Corp.**



Chart provided by [www.BigCharts.com](http://www.BigCharts.com)

**TWST: What macro issues are top of mind for you right now?**

**Mr. Abate:** The war in Ukraine is still a very important topic that seems to be dismissed now due to the current battlefield stalemate, but the risks of potential escalations in that conflict remain very high to us, leading to commodity supply disruptions.

NATO and the U.S. continue to want to pursue a proxy war against Russia in an effort to degrade its armed forces and world stature permanently.

Russia, who had the opportunity to conduct its operations in a more meaningful way early in the conflict and settle it very quickly, has chosen to continue its limited operations, which has done nothing

but prolong the war, and their inability to accomplish their objectives has led to the current stalemate.

It leads to a high degree of complacency and confidence on both sides, which historically has never been a good thing from a war perspective, because it raises the potential for escalation from forces inside Russia and NATO members due to growing frustration on progress. So that's first and foremost what we're concerned about.

The other macro concern is continuing worries about the global profit cycle vis-a-vis equity market valuations. I would say that's always a concern, but to the extent that markets have been very buoyant this year based on risk premiums going down, interest rates being relatively stable, and optimism about profit growth returning in 2024 leads to high expectations.

From our research, we're still in a flat profit cycle, as you're starting to see profit margin deterioration, and this continuing rolling recession, as we've called it, could lead to people's profit expectations falling short.

Most expectations were for a recession at the beginning of the year and a difficult first half of 2023 for stock markets. It looks like we've had the exact opposite of that happen, so now everybody is bullish for the second half of the year, which, as a contrarian, makes us concerned.

**TWST: The so-called energy transition — how does that fit into your investment strategy and what you look at day to day?**

**Mr. Abate:** If you look at the transition to renewable energy, there is no doubt it's happening. As I mentioned before, with companies like **Enel**, half of their capex budget is going towards renewables. Energy storage is the principal issue that's preventing most renewables from taking greater market share, just in terms of the consistency of power generation.

There's one story I always talk about with regard to the importance of adequate infrastructure and its impact on people's lives: Remember in late 2021 when Facebook went down for most of a day, so people didn't have access to Facebook, WhatsApp, and Instagram, and you thought panic was ensuing? Compare that with Texas earlier in the same year, when the entire power grid went down because of ice storms, and almost five million people didn't have power for days in some areas of the state, some longer.

Estimates as high as 700 people were killed as a result of the crisis because of the lack of access to readily available energy from fossil fuel capacity when it was most needed, because of reliance upon renewables that, in certain climates such as ice storms, obviously don't work.

So we constantly remind ourselves and investors of the continuing need for fossil fuels. Until we're able to gain comfort on the economically sensible energy storage of renewable power generation, we think fossil fuels are going to be here for a very, very long time.

If you look geopolitically, there's still a very heavy dependence upon fossil fuels by many governments outside of the U.S. and developed Europe, and a continuation of needing to maintain the trajectory of the middle and lower classes' economic growth for India, China, and other areas of the developing world equates to greater fossil fuel use.

**TWST: Is there anything you would like to add to wrap up?**

**Mr. Abate:** The key thing that we want to stress to people is that there's a very timely opportunity now for listed infrastructure in the world's developed markets in terms of valuation, and it can give a special value-oriented type of complement to overall investment portfolios, not only because of the attractiveness based on traditional value metrics, but also because of the income capabilities of many of the underlying assets of the companies, as well as the natural inflation hedge.

We think the infrastructure category has the capability to be one of the leading investment sector categories for investors as time progresses, and distinguish itself from other thematic areas that will lack persistence of benefits to investors.

At Centre, we deliver a truly active, disciplined, and research-intensive fund that is unique within the category, not only for its monthly distribution capability, but also the geographic and sector portfolio construction and balance, and risk aware approach that we bring to investing. Those are the key characteristics that we want people to associate with the Centre Global Infrastructure Fund.

**TWST: Thank you. (MN)**

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