Time to look again at Ecofin?

I've owned shares in utilities and infrastructure investment trust Ecofin, on and off, for much of the last decade. I originally bought into them after the split cap debacle, thinking that the market had got its valuation wrong. I was right – the shares shot up. But then the fund drifted for a number of years, producing some uninspiring results whilst also churning out a decent income. Last year though the fund underwent a reconstruction and a new Ecofin emerged, with a renewed focus on a broader range of utility and infrastructure stocks. Crucially the funds managers also ditched their slightly boring, value focus and started to move into faster-growing bits of the utilities/infrastructure spectrum. This seemed to pay off, and 2017 was a decent year for EGL. The investment trust delivered NAV and share price total returns of 14.5% and 27.7%, respectively, significantly outperforming the MSCI World Utilities Index which returned 3.8%.

Some things didn't change though. The fund is still focused on generating a decent income and is currently producing a portfolio yield of around 5.2% and the companies in the portfolio are expected to grow their dividends at a compound rate of 6.5% per annum through to 2020.

Crucially though the discount – always fairly stubborn with Ecofin – hasn't really moved that much and is currently sitting at around 13% as I write. That number hasn't been helped by a sharp turnaround in sentiment towards utility stocks – during the three months to 28 February, 2018 the MSCI World Index rose by 0.6% while the MSCI World Utilities Index fell by 11.7%. Shares in Ecofin are down 15.7% over the last quarter.

In truth one could make the argument that Ecofin has been rather unlucky in coming rather late to an exciting party – renewables and infrastructure. For many aeons, the fund was more focused on stodgy but conservative utility businesses. This didn't get it very far except that it provided a nice generous income. Realising the error of its ways, it reconstituted itself and decided to (rightly in my view) focus on sexy areas such as renewable power, yieldcos and infrastructure. The chart below shows the current top ten holdings in the fund using Marten and Co data. Notice big weighty holdings such as NextEra, a large US focused renewables yieldco. Other interesting picks include Finnish outfit Fortum (CHP) and Spanish renewables giant Iberdrola. Interestingly net gearing has also increased to 17% so that more money can be invested in these more growth-orientated stocks.

Figure 4: Top 10 holdings as at 28 February 2018

Holding	Sector	Geography	Allocation 28 Feb 18 (%)	Allocation 31 Oct 17 (%)	Change (%)
NextEra Energy	Renewable energy	US	5.2	2.9	+2.3
E.ON	Renewables and networks	Germany	4.3	3.9	+0.4
EDF	Electricity	France	4.1	3.7	+0.4
Flughafen Zürich	Airport	Switzerland	3.5	1.9	+1.6
Vinci	Transport infrastructure	France	3.4	2.8	+0.6
American Electric Power	Electricity	US	3.4	3.8	(0.4)
Exelon	Electricity	US	3.4	0.0	+3.4
Enel	Electricity and gas	Italy	3.3	2.4	+0.9
Fortum Oyj	Clean energy	Finland	3.2	0.0	+3.2
Iberdrola	Electricity	Spain	3.2	1.5	+1.7
Total of top 10			37.0	39.9	(2.9)

Source: Ecofin Global Utilities and Infrastructure Trust

All in all, then, this all seemed to make a great deal of sense until the last few months.

Cue the bad news. Trump hates renewables, and the infrastructure sector has gone into a funk here in the UK. More ominously many investors are getting more and more concerned about the prospect of increasing interest rates – which might have a negative impact on the utility sector.

So, what might happen next? My guess is that Ecofin might be in for another tough three to six months as investor's price in more aggressive rate rises. I'd wager that we might see another 5 to 10% drift in the share price with the discount moving up to perhaps close to 15% or even 20%. But those dividends paid by Ecofin portfolio companies probably won't come down by too much, which also implies that we could see the yield drift closer to 6%. At that point, my guess is that it might be worth looking again at Ecofin.

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