GRAVIS CLEAN ENERGY

GRAVIS UK INFRA

Investing in infrastructure through inflationary cycles

Investors traditionally rely on the equity-bond relationship to manage portfolio volatility. However, this standard allocation breaks down during inflationary shocks.

To build resilience across the cycle, portfolios can strategically pair broad equities with infrastructure equities to create a comprehensive inflation defence. This is because broad equities capture upside during growth-driven reflation, while infrastructure assets - underpinned by inelastic demand and contractual inflation pass-throughs - protect capital during stagflationary periods when both fixed income and broader equities lag.

Four inflation environments

Economists typically describe four broad inflation environments:

	Deflation	Disinflation	Reflation	Stagflation
Macro environment	Falling prices, usually with weak demand and growth	Inflation slowing but prices still rising: Stabilising/resilient growth	Rising inflation alongside accelerating growth	Rising inflation with weak or falling real growth
Typical interest rate environment	Low and falling: can approach zero or negative	Moderate and falling from elevated levels	Rising from low levels as expansion takes hold	High and rising despite weak growth
Central Bank policy	Aggressive easing: may deploy unconventional tools (QE)	Nearing conclusion of cutting cycle as inflation nears target	Gradual tightening to contain overheating risk	Difficult trade-off: tightening risks deepening growth slowdown

The table over page explains the behaviour of equities, bonds and infrastructure in each of these scenarios. It does so by looking at two dimensions: real cashflow protection and capital values. It also details which sub-sectors will perform well in these different environments.

	Deflation	Disinflation	Reflation	Stagflation
	Mixed	Favourable	Favourable	Mixed
Core infrastructure	Lack of inflation limits nominal cashflow growth Lower yields lift DCF valuations Essential infrastructure with inelastic demand are defensive	Contractual indexation preserves cashflows in real terms Falling interest rates support DCF valuations Resilient growth supports both regulated and demand-linked assets	Contractual indexation preserves cashflows in real terms Rising rates put pressure on DCF valuations Economic growth supports demand-linked assets	Contractual indexation preserves cashflows in real terms Rising rates put pressure on DCF valuations Essential infrastructure with inelastic demand are defensive
	Unfavourable	Mixed	Favourable	Unfavourable
Broad equities	Weak demand hits volumes, fixed costs compress margins, earnings collapse and default risks rise Elevated risk premiums and earnings uncertainty compress valuation multiples Defensive equities lead: utilities, consumer staples, defence, healthcare, energy	Margins stable: earnings growth depends on demand backdrop Growth and long-duration equities benefit most from lower capital costs and discount rates driving multiple expansion Growth and long-duration equities lead: tech, discretionary	Accelerating GDP drives earnings growth, companies with ricing power, volume growth and operating leverage see margin expansion and offset the valuation impact of rising discount rates Broad equity valuation multiples expand Cyclicals lead: financials, industrials, materials, energy, small caps	Costs rise triggered by supply chain shocks, without volume support margines are squeezed, companies with pricing power outperform Broad equity valuation multiples contract as rates remain elevated Defensive equities lead: utilities, consumer staples, defence, healthcare, energy
	Mixed	Favourable	Mixed	Unfavourable
Fixed income (nominal)	Fixed coupons gain value in real terms Investment grade: high quality bonds with long duration outperform High yield: capital values collapse as credit spreads expand and default risk rises	Fixed coupons gain value in real terms Investment grade: high quality bonds with long duration outperform	Inflation expectations push yields higher, fixed coupon erodes in real terms Investment grade: capital losses, particularly in long duration High yield: capital values more resilient as credit spreads tighten offsetting higher risk free rates	Persistent inflation erodes fixed coupons in real terms Capital losses, particularly long duration and lower grade credit

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