

Principal Market



Key Points

- Only the most active secondary markets should be considered when documenting the evolution of investor preferences.
- This 'principal market' provides the best insights into the **market price of risk** for unlisted infrastructure investments.
- Markets included in the Index Universe and asset pricing approach should be principal markets.

The notion of fair value is a *market-based measurement rather than an entity based measurement* i.e. it is concerned with how *average* prices are formed in the most representative markets. In the language of academic finance, fair value is about *betas* i.e. the combined exposure of each firm to priced risk factors. It is not about *alpha*, which represents market outperformance and is the result of proprietary or new information.

Once the relevant **unit of account** is known, fair value accounting requires the determination of a reference or 'principal' market.

The *principal (or most advantageous) market* is the one in which an orderly transaction between willing buyers and sellers is most likely to take place for the relevant asset on the measurement date.

In such markets, however illiquid, buyers and sellers have to be

1. independent
2. knowledgeable about the investment
3. able to transact and
4. willing to transact.

In other words, the principal market is the one in which information about *average prices* can best be observed or derived.

The notion of principal market under IFRS 13 implies that the market used to measure fair value is *representative of buyers and sellers preferences*. It is "the market with the greatest volume and level of activity for the asset or liability" [IFRS 13:Appendix A]. In other words, the point of reference for a broad market index of unlisted infrastructure should be those markets in which average or the most consensus prices are best revealed.

The principal market is the one allowing the best possible measurement of the average prices of the risk factors found in unlisted infrastructure investments, which in turn determine the total price at which buyers and sellers are willing to transact at a given point in time.

This point has direct implications for the definition of the relevant broad market universe used to compute the EDHEC*infra* broad market indices. The choice of universe for a broad market reference index aims to include those markets that are representative of the price preferences of independent, knowledgeable and willing buyers and sellers' on the measurement date. In effect, a 'broad market' index aims to represent the principal market: the one incorporating sufficient knowledgeable participants and transactions to reveal fair price signals. In other words, **the broad market is the principal market** that best represent the preferences of buyers and sellers of unlisted infrastructure investments.

In the case of unlisted infrastructure investments, certain national markets have been active for several decades and, over this time, numerous primary or secondary transactions have taken place. For instance, in countries where public infrastructure was largely privatised in the 1980s, such as the United Kingdom, investors in unlisted infrastructure have been and remain more active.

Likewise, the countries where government implemented large scale infrastructure procurement programs using concession contracts or other forms of 'public-private partnerships', such as Spain, Portugal, France or the UK, represent the core markets in which private infrastructure investors can and do transact, as is also the case of Australia or parts of Latin America.

In these markets, even though infrastructure investments remain highly illiquid and seldom traded, a range of investor preferences can be observed with respect to a significant number of transactions. Under IFRS 13, these markets can be considered to represent the 'principal' market, exhibiting 'the greatest volume and level of activity.'

Conversely, fringe markets with few transactions and active buyers and sellers over time relative to the most 'active' private infrastructure markets may only introduce noise in the assessment of the fair value of market prices, be they total asset prices or risk factor prices. In smaller national markets, investors may only buy or sell one of a few unlisted infrastructure companies, observable valuations can be less useful when it comes to measuring broad market price signals because they include mostly investor- and transaction-specific noise.

Universe Inclusion Criteria: National Markets

National markets that are principal markets and can be included in the broad market universe should exhibit a minimum level of activity both in terms of number of transactions and individual buyers and sellers. The measurement of this activity should also be possible, hence a minimum level of transaction information should be available.

Inclusion criteria for individual national markets include:

- A minimum number and volume of primary or secondary market activity, indicating that more than a few isolated transactions took place on each measurement date;
- A minimum size (expressed in book value) relative to the existing broad market universe, suggesting that the addition of the market in question would increase the information content of a broad market index;
- A minimum level of audited financial information about the relevant investable infrastructure companies in the market.

While the last criteria is not a function of market activity, it represents a minimum level of market transparency below which it is not even possible to assess the contribution of a national infrastructure market to the broad market broad market.

As of 2020, the markets that meet these criteria include, for the most part, a majority of OECD countries and a few so-called emerging markets.



Find out more

The criteria used by EDHEC*infra* to include national markets in its global broad market indices are detailed in the [Unlisted Infrastructure Universe Standard](#).