

May 15, 2020

## Dear Clients and Colleagues:

With central banks playing their part to help mitigate the impact of COVID-19, attention is turning to how governments will help support the post-pandemic economy. Having cut interest rates to almost zero and initiated several lending and liquidity programs, the Federal Reserve Chairman Jerome Powell seemed to suggest the ball was firmly in Congress's court. Powell said, "Additional fiscal support could be costly, but worth it if it helps avoid long-term economic damage and leaves us with a stronger recovery. This tradeoff is one for our elected representatives, who wield powers of taxation and spending."

One could argue that providing financing quickly and directly to both individuals and companies was the appropriate action given how the economy came to a relative standstill. It is likely that any near-term packages will continue to focus on the unemployed and small and medium enterprises. Yet going forward it would be rational to expect these payments to be saved rather than spent, as cash (preservation) is king.

With the United States (US) in an election year, a key focus will be how to best aid economic recovery in 2021, and the conventional playbook is to turn to fiscal spending, where investing in infrastructure is one way to stimulate the economy. Helping the infrastructure industry has many benefits. Firstly, it is labour intensive, accounting for almost 8% of the global workforce. It has the ability to take workers from other sectors where unemployment may be more permanently impacted. Infrastructure projects can also target specific areas that have been hardest hit from the COVID-19-inflicted recession. Many small, local businesses – those most at risk of bankruptcy – will supply raw materials, as well as other goods and services, leading to a trickle-down effect to the economy.

Therefore, it is reasonable to assume a large infrastructure bill will be in the cards. President Trump has already been vocal about rebuilding American roads, bridges and airports. House Speaker Nancy Pelosi has also advocated for infrastructure investment as part of the response, focusing more on health care and the digital economy, but as yet the two sides have not come to an agreement.

Across the pond, the United Kingdom (UK) government unveiled a £640 billion infrastructure spending plan for 2020 to 2025. Announced at the start of the pandemic in the UK, the budget will see increased spending on roads, railways and an ambitious target for new homes. The UK still has Brexit on the horizon, and the new immigration system and its potential impact on labour availability remains to be seen. Nevertheless, construction output is forecasted to increase by around 2.5% in 2021 and 2022 due to the infrastructure spending plans.

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The Japanese government announced its largest-ever stimulus package of 117 trillion yen, equivalent to 20% of its GDP, of which direct fiscal spending totals 48.4 trillion yen. In previous economic downturns, Japan has invested heavily in airports, railways, highways and tunnels.

With infrastructure programs slow to get going, the key to having an impact on the recovery is to find “shovel-ready” projects or those that have a simpler and faster approval process. One such example is maintenance projects because they have the added advantage of being labour intensive. This could also be an opportunity to accelerate projects that could have a long-term social or environmental benefit. These could include improving healthcare infrastructure, affordable housing, improved water treatment and waste management facilities, and renewable energy projects.

Further examples of suitable projects include the £500 million a year pothole project in the UK, and the Canadian government setting \$2 billion aside for projects to clean up abandoned oil wells. The Canadian Chamber of Commerce wrote to the Infrastructure Minister asking for an advance on money that was to be spent in the coming years, citing the \$2 billion National Trade Corridors Fund that had more proposals than could be initially funded. The projects that had merit, but lacked funds, could potentially start up quickly. As the US is in an election year, passing a \$287 billion highway bill that was proposed last year may be one step too far, but an extension of the current deal would support infrastructure activity.

Those who oppose an increased infrastructure bill cite the politicians’ inability to allocate to the correct projects, an increasing debt load and the fact that one of the constraining factors for construction was the shortage of available workers if other sectors return to pre-COVID-19 employment levels and immigration remains tight. Opponents prefer to focus on stimulating private sector investment, using idle capacity and encouraging rehiring.

Here are some of our holdings that would benefit from increased infrastructure spending:

### **Eagle Materials (EXP: US)**

Headquartered in Dallas, Texas, Eagle Materials Inc. is a leading provider of building materials that serves markets throughout the US. Their operations are segmented by product group and include cement, gypsum wallboard, recycled paperboard, concrete and aggregates, and oil and gas proppants divisions. Public highway construction is a large consumer of aggregates (crushed stone, sand and gravel), using between 40 and 80 thousand tons of aggregates per mile for a four-lane highway, compared to 120 to 400 tons for a housing start.

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### **SHO-BOND (1414: JP)**

SHO-BOND is Japan's largest specialist in reinforcing, repairing and maintaining heavily used bridges, tunnels and other concrete structures. It also manufactures in-house filler for concrete measures, resin sheets to prevent concrete collapse and materials used in installing dampers for earthquake resistance; 95% of its revenues come from public projects.

### **Urban & Civic (UANC: LN)**

Urban & Civic (UANC) is the UK's leading Master Developer. A Master Developer is responsible for obtaining planning permission and delivering the community infrastructure in a serviced land parcel to house builders. The company has nine sites in its portfolio, with 33,500 homes consented and submitted, and six commercial sites. UANC has a 785-acre strategic site in Buckinghamshire and anticipates 5,000 houses can be built upon it. This location is very interesting, as the site adjoins the new High Speed 2 (HS2) depot where HS2 will meet the proposed East-West rail line.

### **Federal Signal (FSS: US)**

Federal Signal manufactures specialized safety, signaling and communications equipment. The Environmental Solutions Group accounts for 80% of revenues and produces street sweepers, sewer cleaners, water blasting equipment and road marking vehicles among others. The various levels of US government account for almost half of total revenues.

### **Bucher (BUCN: SW)**

Bucher is a diversified industrial group and although it is mostly exposed to agriculture, it also supplies municipal vehicles such as street sweepers, winter maintenance machines and sewage cleaning vehicles. Bucher Municipal is the European market leader in sweepers and winter maintenance vehicles.

Have a nice weekend.

The Global Alpha team

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