FORTEM CAPITAL

FRIDAY NIGHT 'LIGHTS

Infrastructure and the Election

11th November 2016

Following on from potentially the most surprising political event of the 21st century (apparently, my hockey club's AGM narrowly missed out on that title) we look to the future. What exactly does Trump plan to do, what would the US senate allow him to follow through with, and how best might an investor benefit from his Presidency?

We are in a unique position in recent politics, whereby for once the major fear is that an elected official might *actually* do what they said they would on the campaign trail. Let us assume for the sake of our sanity, that some of the more populist suggestions he made are unlikely to be enacted into law and look simply at his fiscal policies. On domestic economic policy, the single greatest area where Trump is likely to find his way undeterred by a Republican Congress would be tax cuts and deregulation; examples of capital-friendly policies, that are obviously helpful to cyclical equities and the banking sector. Perhaps further afield we might see pro-cyclical fiscal policy and more optimistically, normalisation of interest rates and even long term economic growth. Eric Lonergan of M&G made the interesting point that the "greatest irony of this latest outpouring of populism may well be a set of policies which favour capital over labour, and look more Keynesian than neo-liberal."

So, on those lines, is there an overriding Keynesian investment theme? Well, the core of his transformative vision is to instigate a country wide splurge on infrastructure. A united government may also remove partisan obstacles to meaningful infrastructure spending and developments in the more traditional energy sectors. In his victory speech (the tone of which was surprisingly presidential) he stated the following:

"I've spent my entire life in business looking at the untapped potential in projects and people around the world. That is what I now want to do for our country… We're going to rebuild our infrastructure, which will become second to none."

To move far beyond just the US and this election, there has been a growing interest in infrastructure for quite some time now. In a report published by Linklaters in 2014, global institutional investors have $1 trillion of funds to invest in Europe in the decade 2014–2023. This huge figure is being fuelled by interest from investors in Canada, Hong Kong, China, the Gulf Cooperation Council (GCC) region, Japan, and South Korea. Investments from these countries in European infrastructure assets between 2010 and 2013 rose by 465% compared with the previous four years.

Furthermore, PWC have posited that close to $78 trillion is expected to be spent globally between 2014 and 2025, doubling the current level of yearly global expenditure. Within their analysis, they've looked at some key worldwide fundamentals. By 2020, China will have completed 31,000 miles of high-speed railways. By 2030, there will be an additional 165 million urban dwellers in India; they will need housing. And by 2040, 4,400 GW of additional power-generation capacity will need to be created to meet worldwide demand for electricity.

Global Construction 2030 predict that global construction output will grow by 85% in the next 15 years. Governments will be central to this, but as has been so abundantly apparent since the financial crisis, cash isn't easily available. Alternative funding is therefore critical; the divesting of assets into the private sector to ensure reinvestment into the next project is becoming more and more common for example.

Product	Coupon
6yr Autocall, FTSE 60% EKIP, Barriers 100/100/100/100/100/100	11.10%

Rates (bps)		
	Current	Week Chge
GBP 1yr	56.90	0.00
GBP 3yr	68.60	3.60
GBP 5yr	85.20	8.80
Equity Indices (%)		
FTSE 100	6917.14	3.34%
S&P 500	2151.13	3.16%
Nikkei 225	17442.40	3.18%
Eurostoxx 50	3023.15	2.32%
Currencies (%)		
GBPUSD	1.2238	-2.23%
5yr Credit Spreads (bps)		
Citigroup	79.81	-2.96
Credit Suisse	138.84	-1.95
Deutsche	232.38	-1.83
GS	93.16	-3.09
HSBC	65.57	+1.31
JPM	64.30	-1.66
MS	90.30	-2.74
Commodities (%)		
Gold	1288.70	-1.25%
Oil	46.67	5.90%
3m Implied (vol pts)		
FTSE 100	15.20%	+1.26%
S&P 500	13.25%	-3.08%
Nikkei 225	19.14%	+1.63%
Eurostoxx 50	19.34%	-2.61%
5yr Implied (vol pts)		
FTSE 100	20.01%	+0.25%
S&P 500	20.48%	-0.83%
Nikkei 225	19.17%	+0.19%
Eurostoxx 50	20.11%	-1.29%

Source Bloomberg / Partner Banks
Data as at 11th November, 11.45am

Upcoming events	
15th Nov	UK CPI % y/y
8th Nov	Eurozone GDP % q/q
17th Nov	ECB Minutes released

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But, how to access these deals when they are largely the preserve of private equity, global sovereign wealth funds and, more recently, sizeable pension funds? Global infrastructure equity indices up to now have been far too volatile and tracked equity markets far too closely, while individual equities, though potentially profitable are regularly too narrowly focused on a geographical region or industrial sector and don't offer the diversification that a basket of multiple stocks can provide.
Thus, our client base has typically used Infrastructure Investment Trusts to good effect. They are reasonably liquid, have a low beta to global equity markets, thereby acting as a solid inflation-linked defensive asset, while ensuring a consistent stream of income. The ongoing debated surrounding these securities however (baring their trading at a premium), is whether these ITs will benefit from the highlighted growth in projected spend?

So, the question is; if access to actual infrastructure assets may be beyond all but the very large institutions and sovereign wealth funds, ITs, whilst having a part to play are likely to provide more bond like returns, and open ended vehicles are potentially ill-suited to the assets of infrastructure (for some of the reasons we've seen in the commercial property sector recently), how can one access the potential capital growth of the infrastructure sector? Perhaps the answer is a well thought through strategy that selects fundamentally sound companies and debt thereof from across the world that provide products and services to infrastructure and therefore over the medium to longer term should benefit from the significant infrastructure build out globally.

We will leave that to you to decide, but suffice it to say Fortem will be in touch soon…

Disclaimer

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