Insights & Strategies

PRIVATE CLIENT SOLUTIONS

May 3, 2021

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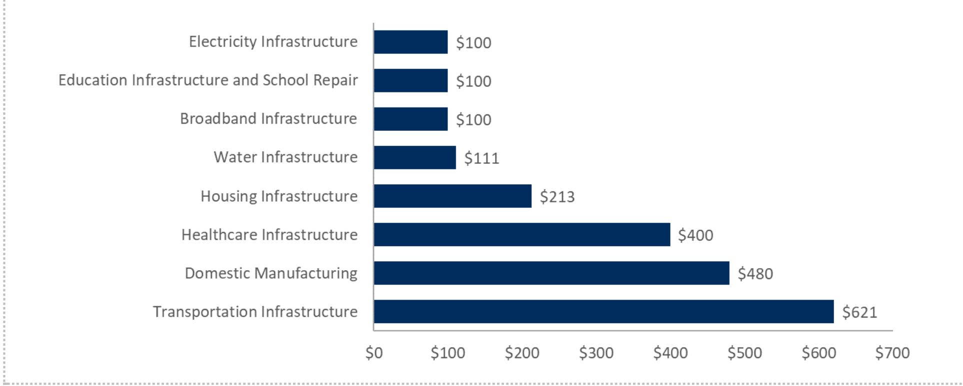
US Infrastructure: The Icing on the Cake

The US economy has come roaring back from the depths of the crisis with real gross domestic product (GDP) forecasted to grow by 6.3% in 2021, up from -3.5% in 2020. Consumer and business fundamentals continue to show clear signs of strength, underpinned by trillions in COVID-19 fiscal stimulus (+26% of 2020 GDP) introduced since the beginning of the pandemic. High levels of pent-up demand (excess savings as % of GDP: 8% as at Q4/2020), and solid progress on the vaccination front (42% of the US population has received at least 1 dose of the COVID-19 vaccine) remain key catalysts for the economy to surge ahead of expectations. While the outlook for the US economy remains robust, and with the ink barely dry on the recent US$1.9 trillion American Rescue Plan, the US administration is proposing more "icing on the cake" with the first of a two-phase infrastructure plan which, taken together, could total as much as US$4 trillion in spending or 20% of 2020 US GDP.

The focus for this issue is "phase one" of the larger infrastructure plan, called the American Jobs Plan, which includes ~$2.3 trillion in new spending over eight years. Among the major spending initiatives: **1)** $621 billion for transportation infrastructure; **2)** $480 billion for domestic manufacturing; **3)** $400 billion to expand health care infrastructure; and, **4)** $213 billion for housing infrastructure. To cover the cost of the new spending, the administration has proposed changes to the corporate tax code, including increasing the corporate tax rate from 21% to 28%. The White House estimates the changes will raise +$2 trillion over 15 years.

While we do see a clear path forward with the eventual passage of the "phase one" infrastructure package later this year, we caution investors that the initial details are subject to change in negotiations over the coming weeks/months. We do expect the overall top-line figure of close to $2 trillion for this package to stay constant for phase one of the plan. Below we provide: **1)** a brief overview of the current state of US infrastructure; **2)** the multiplier effect of public spending; and, **3)** final thoughts for investors.

Biden's ~$2.3 Trillion American Jobs Plan ($US bln)



Source: The White House, Raymond James Ltd.

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US Infrastructure Receives a Failing Grade

Infrastructure is a core component of every society, with public and private infrastructure spending an essential element to improving the productivity and living standards of the population. Every four years, the American Society of Civil Engineers (ASCE) issues a report card and estimates the investment needed in each infrastructure category to maintain a state of good repair and earn a grade of B. In the 2021 Report Card – For America's Infrastructure, US infrastructure as a whole received a failing grade of C-. Despite making incremental gains in some of the categories over the past several years, the long-term investment gap (total infrastructure need minus investments funded) has increased from $2.1 trillion to $2.6 trillion over 10 years from the previous report issued four year ago.

The ASCE estimates that by 2039, continued underinvestment in US infrastructure at current rates will cost $10 trillion in GDP, more than 3 million jobs in 2039, and $2.24 trillion in exports over the next 20 years. Said differently, poor roads and airports will equate to lower productivity and longer travel times. An aging electric grid and inadequate water distribution make utilities unreliable. Problems like these translate into higher costs for businesses, lower productivity of the workforce, and reduced output for the economy. These higher costs, in turn, get passed along to workers and families, and according to recent ASCE estimates, the cost to the average American household would equate to $3,300 a year, or $63 a week if the current gap is not addressed.

$2.6 trillion Infrastructure Gap over 10 yrs. ($US bln)

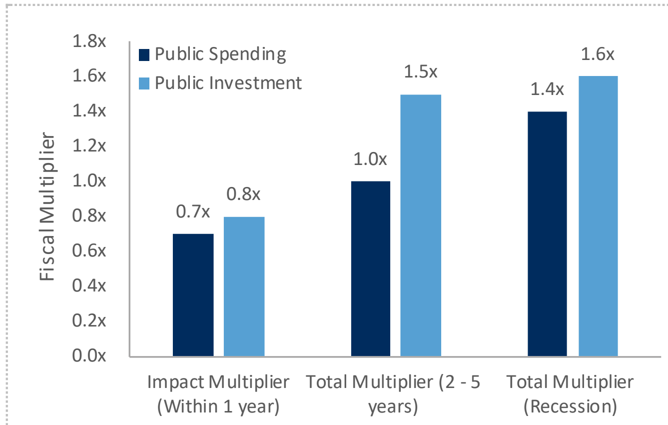
Infrastructure System	Total Need	Funded	Funding Gap	Full/partial funding included in the American Jobs Plan
Surface Transportation	$2,834	$1,619	$1,215	✓
Drinking Water / Wastewater / Stormwater	$1,045	$611	$434	✓
Electricity	$637	$440	$197	✓
Airports	$237	$126	$111	✓
Inland Waterways & Marine Ports	$42	$17	$25	✓
Dams	$94	$13	$81	
Hazardous & Solid Waste	$21	$14	$7	
Levees	$80	$10	$70	
Public Parks & Recreation	$78	$10	$68	
Schools	$870	$490	$380	✓
Totals	$5,937	$3,350	$2,588	$2,250

Source: American Society of Civil Engineers, Raymond James Ltd.

The Case in Favour of Infrastructure Spending

According to the Global Infrastructure Hub (GI Hub), public investment in infrastructure has shown to be more effective than other types of public spending in increasing economic output, particularly over the medium to long term. This is the core finding from the GI Hub's recent analysis of 3,000+ estimates of the fiscal multiplier from more than 200 academic studies over the last 25 years. This analysis, conducted to support the G20's Action Plan in response to the COVID-19 pandemic, found that public investment has an average fiscal multiplier of about 0.8x within 1 year, and around 1.5x within 2 to 5 years. This implies that for every $1 invested in public infrastructure, the total output for the economy should increase by $0.80 in year 1 of spending, with $1.50 (or 50% of the original investment) added to the economic output between 2-5 years.

1.5x Cumulative Multiplier for Infrastructure Spending



Source: Global Infrastructure Hub

Final Thoughts for Investors

While we do see a clear path forward for the "phase one" infrastructure package later this year, we caution investors that the initial details are subject to change over the coming weeks/months. While we assign a low probability of the bill not passing, speculating and positioning ahead of this formalization remains a risky proposition for investors. Moreover, we remind investors that infrastructure spending, unlike monetary or other forms of fiscal spending, is less immediate in nature, with the impacts to company fundamentals and more so, the real economy, realized over a longer time horizon. For example, the American Jobs Plan is proposing new spending over eight years.

With this in mind, we believe investors can remain patient for phase one of the broader infrastructure plan to pass before adding to names (e.g., engineering and construction companies) which remain well positioned to benefit from the increased infrastructure spending in the US.

Nadeem Kassam, MBA, CFA
Head of Investment Strategy

Paving the road ahead

Infrastructure is an important component of the economy as it provides work, supports trade, connects employees to their jobs, and powers businesses. President Joe Biden's American Jobs Plan (AJP) not only focuses on the roads and bridges that require much-needed improvement, but also shines a light on green infrastructure, digital infrastructure, and research and development (R&D), among many other areas. For those expecting the proposed ~$2.3 trillion plan to pass in Congress, we highlight certain industries we believe may benefit from almost $1 trillion in increased government spending related to transportation, broadband and power.

Transportation

Over a quarter of the Biden administration's ~$2.3 trillion proposed investment, or $621 billion, will be spent on transportation infrastructure, which includes refreshing 20,000 miles of road, repairing 10,000 bridges and improving railways and airports. Funds will also be allocated for electric vehicles (EVs) and modernization of public transportation, which includes expanding EV infrastructure with 500k new charging stations, replacing diesel transit vehicles, electrifying federal vehicles such as postal trucks and ambulances, providing subsidies to EV manufacturers, and tax incentives for consumer EV purchases. Areas that may benefit from investment in traditional infrastructure include engineering and construction firms, construction equipment and machinery manufacturers, power tool makers, and producers of construction materials such as aluminum, steel and cement. Given the AJP's focus on EVs, auto companies that make EVs, zero-emissions light rail/bus manufacturers, charging station manufacturers, and makers of components within the clean technology value chain may also be in a good position to benefit. Materials such as copper for electrification and lithium for energy storage may also see a boost in demand.

Broadband

The plan also touches on infrastructure that is important to today's digital economy with a $100 billion investment in broadband including the goal of extending high-speed internet coverage to over 30 million Americans that lack access. Such efforts would benefit network equipment providers focusing on underserved regions, fiber line makers that create the broadband systems, cell tower makers, software platform providers and semiconductor companies. An additional $50 billion is being earmarked to subsidize semiconductor R&D and manufacturing, which may accelerate positive trends within the space related to EVs, 5G and automation.

Power

The AJP also allocates $100 billion in funds to improve the resiliency of the electrical grid and help achieve American-made carbon-free electricity by 2035. The bill calls for extending/providing new tax credits for energy storage and generation, development of new transmission capacity, and assisting clean-energy producers with R&D. Companies that focus on wind/solar generation, energy storage and build transmission lines may find opportunities from increased government investment.

Some Beneficiaries of the American Jobs Plan

Ticker	Name	Market Cap (bln)	Dvd. Yld.	US Rev %
Machinery				
CAT-US	Caterpillar Inc.	$126	1.8%	37%
DE-US	Deere & Company	$119	0.8%	53%
Specialty Contractors				
PWR-US	Quanta Services, Inc.	$14	0.2%	86%
Construction & Building Materials				
VMC-US	Vulcan Materials	$24	0.8%	100%
MLM-US	Martin Marietta Mat.	$22	0.6%	99%
J-US	Jacobs Engineering	$18	0.6%	75%
FLR-US	Fluor Corporation	$3	0.4%	54%
Utilities				
NEE-US	NextEra Energy, Inc.	$153	1.8%	100%
AEP-US	American Electric Power	$44	3.3%	100%
Power Infrastructure				
ETN-US	Eaton Corp. Plc	$57	2.1%	56%
Semiconductor				
NVDA-US	NVIDIA Corporation	$385	0.1%	19%
AVGO-US	Broadcom Inc.	$193	2.9%	20%

Source: FactSet, Raymond James Ltd. Priced as at April 27, 2021.
Note: This is a non-exhaustive list of companies and is meant to provide examples of companies that may benefit.

Final Thoughts

Investors interested in adding exposure to areas that may benefit from increased infrastructure spend should keep in mind that such projects take time to plan and build. The AJP still needs to obtain approval from Congress, and it will take time before any increased government spend materially impacts company financial results; however, some analysts expect impacts as early as 2023. This said, our team continues to favour cyclical areas of the market within portfolios with exposure to industries/sectors that may not only benefit from stronger economic growth, but also increased US infrastructure spending.

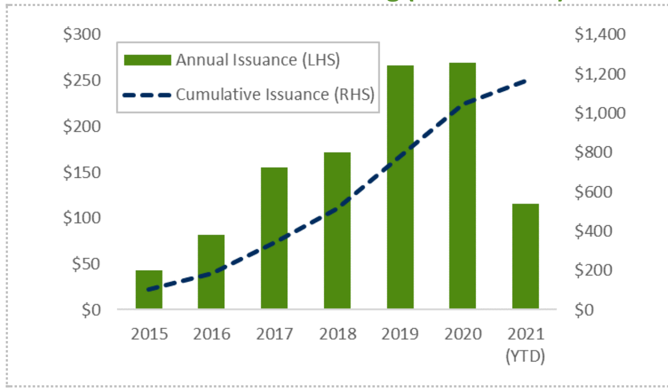
Larbi Moumni, CFA
Portfolio Manager

Greener pastures ahead

The American Jobs Plan highlighted President Joe Biden's commitment to rebuilding the US by focusing on infrastructure improvement across key areas including transportation, manufacturing, health care and housing. In its recently released budget, the Canadian Federal Government made some similar infrastructure improvement promises along with a heavy focus on supporting Canadians through the COVID-19 pandemic. Both countries earmarked funding for green initiatives (e.g. reducing emissions, green energy creation, and supporting electric vehicle infrastructure), which, beyond furthering economic growth, aligns with an expanding focus on ESG (environmental, social and governance). Despite projected time lags to the projects themselves, which is common for infrastructure builds, we find comfort in the overall shift in thinking about the future. Our *Market Perspectives* released February 5 was a green bond primer, providing an overview of what they are and detailing their market in Canada. Here, we provide a brief update on the Canadian sustainable financing market; how we see it shifting in the near future; and what it might mean for those who are interested in these products.

Traditionally, governments raise funds by issuing debt or through taxation. To assist in paying for the American Jobs Plan, the Democrats are seeking to increase corporate taxes from 21% to 28%. Here at home, for the first time, we will see the issuance of a Government of Canada green bond, targeted to fund projects geared at combating climate change. At approximately $5 billion, the amount looking to be raised may seem large, but represents only 2% of the overall bond issuance at the federal level in the fiscal year. We anticipate that a successful sale of federal green bonds will encourage future issuance, both by governments and corporations with sustainable initiatives to fund. It's worth reminding readers that the creation of a green bond benchmark curve, from which other bonds are priced, should have a large positive impact on the domestic market. In fact, although many Canadian banks have issued sustainable bonds in the past, they have focused on overseas markets that are more established. Perhaps this is the change that will encourage them and other corporations to turn back to their home and native land for ESG funding going forward.

Global Green Issuance Growing (US$ Billions)



Source: www.climatebonds.net, Raymond James Ltd.

When it comes to your money, we recommend aligning your investments with your ability and desire to take on risk for a particular return, your asset allocation, and unique factors that may impact your financial situation. Today, investors are increasingly focused on ensuring that their portfolio aligns with their personal views, especially with respect to the environment, social issues and the way corporations are governed. However, it is worth being aware of the way that sustainable bonds seem to trade versus their non-sustainable counterparts to see if purchasing them makes economic sense. In many cases, these greener options trade with lower yields. Choosing the sustainable security may be more notable in some cases (e.g. you are investing in an oil company's transition to green energy, but do not want to fund their traditional energy projects), but not in others (e.g. where a large/majority share of their funding goes towards initiatives you feel comfortable supporting).

Sustainable Bonds May Trade Tighter

Source: FactSet, Raymond James Ltd.

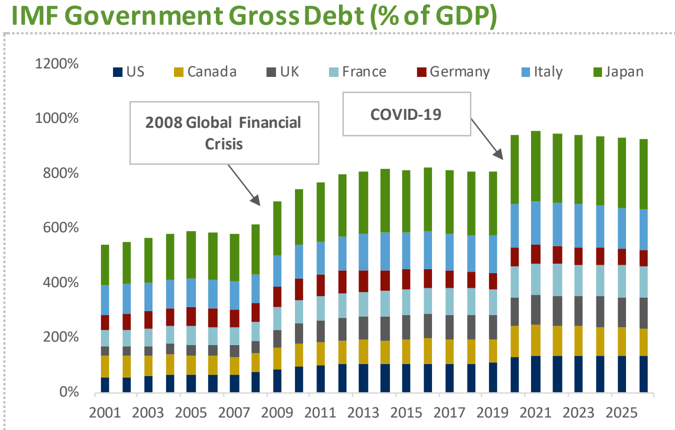
Charlotte Jakubowicz, CMT
VP, Fixed Income & Currencies

FX: Can infrastructure underpin US dollar strength?

While President Biden's ambitious infrastructure plan announcement largely came and went without any major surprises, the main question for markets is whether the United States will see a material lift in its growth outlook going forward, and if this will result in a spillover effect for the broader US dollar. Reaction in bond markets following the release of Biden's infrastructure proposal was rather subdued; the fact that a big portion of the required spending will be financed by higher taxes instead of additional debt issuance kept a lid on yields. As a result, the broader US dollar, proxied by the DXY US Dollar Index, was not able to benefit from a pickup in yields as many had initially envisioned. However, it is important to note that, while US-led growth is one reason many are calling for the US dollar to outperform in the coming months, real economic effects from infrastructure spending will be felt over the medium to long term, as opposed to monetary stimulus and other forms of immediate fiscal spending.

Putting Biden's infrastructure plan aside for a moment, concerns have naturally began to mount over countries amassing record-level amounts of debt. It is important to note that markets will not be punishing debt-fueled spending binges until the global economic recovery is well underway, especially as it relates to FX markets. However, participants are also not blind to what this level of borrowing could mean for these nations down the road. As shown in the following graph, IMF measures of gross debt as a percentage of GDP are up considerably across the G-7, with a notable spike in early 2020 at the onset of the global COVID-19 pandemic.

IMF Government Gross Debt (% of GDP)



Source: FactSet

Looking at YTD performance of G10 currencies versus the US dollar, it is quite evident that the commodity-linked currencies have been the clear outperformers thus far. Surprisingly, we have not witnessed a material pass-through to FX markets despite a +30% rally in WTI crude oil prices and an unprecedented +25% rally in copper YTD, which is currently trading at a 10-year high due to supply bottlenecks, reduction in inventories, expectations of stronger demand coupled with Biden's infrastructure plan and a weaker US dollar. Interestingly, since last August, CAD's correlation to copper has been increasing while its correlation to oil prices has steadily decreased. We believe strong economic momentum created by the post-pandemic global recovery and central bank expectations are behind a lot of the recent price action we have seen. Case in point, the Bank of Canada's (BoC) recent "hawkish taper" announcement, making it the first major central bank to signal that it would pare back asset purchases and move up its expected timeline for potential rate hikes (in addition to the Norges Bank), sent the Canadian dollar flying nearly 2% higher from pre-BoC release highs. In response to the BoC's taper announcement, US/CDN yield spreads have narrowed (in Canada's favour), which has provided an additional tailwind for the loonie.

2021 YTD G10 Performance vs USD

2021 YTD G10 Performance vs. USD

Currency	%
NOK - Norwegian krone	3.49%
CAD - Canadian dollar	2.64%
GBP - British pound	1.68%
AUD - Australian dollar	1.38%
NZD - New Zealand dollar	0.72%
DKK - Danish krone	-0.99%
EUR - Euro	-1.06%
SEK - Swedish krona	-1.83%
CHF - Swiss franc	-3.18%
JPY - Japanese yen	-4.47%

Source: FactSet; As at April 26, 2021

Overall, President Biden's infrastructure package is indeed centered around an "America first" theme, which should be supportive for the US economy over the medium to long term. The US dollar should also enjoy some healthy gains if this exacerbates expectations for the US-led growth narrative; however, we do expect the USD to continue trading defensively for now as the evolving global growth story continues to gain legs.

USD/CAD Short-Term Outlook: 1.2250 (2018 low) is now the next key level of support to keep an eye on, followed by 1.2060 (2017 low).

Ajay Virk, CFA, CMT
Foreign Exchange

Building a bridge to a brighter future

Infrastructure is a unique asset class that can provide many benefits to a portfolio. It is tangible, built over decades, and has a view on the long term. The economic prosperity of most, if not all, modern countries is dependent on sustainably planned and built infrastructure. Governments build much of the traditional infrastructure we rely on, such as roads, bridges and transit. That is because major projects like these are large, expensive and risky. These assets can also be too economically sensitive for a country to privatize. So where can investors reap some of the benefits of this asset class? In this article, we walk through the important characteristics of infrastructure, why it is an attractive asset class, and the best way to gain exposure in your portfolio.

Characteristics of Infrastructure

We design modern infrastructure to last a long time, ideally a lifetime. Given infrastructure's societal importance and the long-term operating contracts associated with it, we expect fewer short-term cyclical market impacts. All of this is true, but it is truer of privately listed and government-owned assets. However, investors can still benefit from this asset class.

While many traditional infrastructure assets may be private, the companies that build, maintain and service these assets are typically public. Active managers in the infrastructure space have long argued that, although the pool of publicly listed infrastructure is small relative to the private landscape, only the best assets go public. In their opinion, while public markets do not have access to the traditional hard assets, they get the best of the best. This may be true to an extent, but it is also important to take this point with a grain of salt. Cyclical economic influences affect publicly-traded companies given the liquidity demanded by public markets. This detracts from the major benefit of infrastructure, which is its illiquidity premium.

Why Invest in Infrastructure

Governments around the world have recognized the importance of infrastructure for their economic well-being, and are investing accordingly. While the United States garners headlines for their ~$2.3 trillion infrastructure bill to be funded over 8 years, Canada plans to spend more as a portion of GDP, and sooner. Canada announced $100 billion over three years, which works out to a little over 1.6% of GDP per year, vs 1.3% of GDP per year for the US. Regardless, governments are spending big on infrastructure, and we think it makes sense to invest along with them. The key with such an investment, however, is patience. Major projects take years to plan, and longer to build. Once built, again, they can last a lifetime. We see an allocation to infrastructure in a similar light.

Infrastructure can make an excellent staple in most portfolios given the characteristics described here. While Canada is punching above its weight class in terms of investments, we typically look for global exposure when it comes to infrastructure. This helps in two key ways. First, it removes any individual source of political or economic risk. As noted above, large infrastructure projects inherently require large amounts of both financial and political capital. Second, different countries have different infrastructure challenges, providing a greater and more diverse set of assets.

Ways to Gain Exposure

Depending on your portfolio positioning, this convoluted sector lends itself well to both actively managed offerings as well as index-based solutions. For those looking to capitalize on headline spending, with a temporary directional view on market sentiment or the position is small relative to portfolio size, index ETFs make sense. These low cost, diversified baskets of companies provide immediate economic exposure to the sector globally. Two options in the ETF space make good passive options. First, **iShares Global Infrastructure Index (CIF-T)** tracks the Manulife Global Infrastructure Index. The index employs a proprietary, quantitative selection process of companies involved in the infrastructure sector. **BMO Global Infrastructure ETF (ZGI-T)** follows a more traditional route, and tracks the Dow Jones Brookfield Global Instructure North American listed Index.

Our preference would be to approach infrastructure actively, particularly for larger allocations, as active managers can measure and weigh the importance of long-term servicing contracts, project pipelines, etc. **Dynamic Global Infrastructure Fund** led by Oscar Belaiche is one fund we suggest you consider. The dynamic team employs a quality at a reasonable price framework and runs a concentrated portfolio. They look for three specific business models including regulated firms (e.g. electrical and water), long-term contractual (renewable power, data infrastructure) and GDP sensitive such as toll roads and airports. We believe this is a long-term winning strategy.

An allocation to infrastructure can be a great diversifying component in your portfolio. However, we believe it is key to have a long-term outlook for assets that are designed to last a long time.

Spencer Barnes, MSc., CIM
AVP & Portfolio Manager, Mutual Fund & ETFs Strategy

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