2nd March 2016

US $500 billion for US infrastructure and commodities

A victory for Hillary Clinton would favour those investing in infrastructure and alternative energy. Commodities are heading towards an upward cycle.

Key Points

- Decaying infrastructure drags down the competitiveness of the US economy
- US infrastructure requires US $500 billion of investment each year until 2020
- This issue lies at the very heart of the presidential debates
- A victory for Hillary Clinton would suggest that the government will do more in terms of infrastructure
- A bank would be created specifically to finance infrastructure
- A change in government strategy would be positive for the commodity cycle
- An increase in infrastructure spending in the two biggest global economies suggests an increase in demand for commodities
- Start of a new upward cycle in commodities
- Outperformance is likely

US infrastructure requires US $500 billion of investment annually

The state of infrastructure in the United States has seriously deteriorated over the last 30 years due to a lack of investment and insufficient renovation projects.

The ASCE (American Society of Civil Engineers) paints an enlightening picture of the quality of the country's infrastructure since 1988, showing that most infrastructures only earns a middling grade on a scale from A to F.

Roads, public transport, canals and aviation are in bad condition, and deemed to be "at risk" (D). Many structures are coming to the end of their lifespan, or are at high risk of serious damage.

Ports, railways and bridges (C) are in sub-standard condition, requiring specific follow-up.

None of the seven main categories that make up the overall infrastructure system in the United States gained a satisfactory score.

Below are some figures to illustrate the situation in various sectors:

- The road network stretches 6,500,000 km, of which 32% of major connections are in poor condition.
- 45% of Americans have no access to public transport.
- The average age of the country's 607,000 bridges is 42 years; 11% are sub-standard, but remain in use.
- 70% of the USA's 84,000 dams will be over 50 years old by 2020.
- 14,000 are considered to be very dangerous due to settlements downstream. 2,000 of these are in sub-standard condition.
- Of the 160,000 km of existing dykes and seawalls, 22% have been rated dangerous and 70% are borderline as to being acceptable.
- More than 50% of highways are over 45 years old.

The ASCE estimates that total financing needs for the next five years stand at nearly US $500 billion per year, for a total of around US $2.5 trillion.

The lion's share of this funding is needed for two major sectors- surface transport (bridges, roads and rail) and electricity production.

Financing these projects is one of the key issues in the presidential elections. Each side has their own point of view, and this subject will certainly be debated at greater length once the two final candidates have been chosen, which will probably be in July.

In the United States the issue of infrastructure lies at the very heart of political debate in general, and particularly the presidential elections

Although Democrats and Republicans agree on the fact that their infrastructure is in a sorry state of disrepair, they are far from agreeing on how urgent the problem is, and how to solve it. Despite this, a recent survey shows for example that 95% of Americans are concerned by the current situation and want their drinking water supply and water drainage systems to be improved; as it currently stands, a major pipe bursts every two minutes.

The candidates for the Republican nomination have adopted an increasingly aggressive tone during the campaign for the primaries in the United States. They all seem to have forgotten their respective manifestos in a bid to take on the billionaire Donald Trump. Mr. Trump says that he has ideas to tackle the issue of infrastructure, and that he would do so better and quicker than any of the others. However, he is also training all of the others' energy on fighting him in a last-ditch counter-attack, leaving but very little space to actually look at the solutions put forward by the Republicans in order to tackle the issue of bringing the country's infrastructure up to scratch. On the issue of climate change, Mr. Trump believes it is a hoax, whilst Mr. Rubio does not believe that human activity is the cause. Both are prepared to repeal the US Environmental Protection Agency's Clean Power Plan, which is viewed as costly and ineffective in environmental terms. For his part, Mr. Cruz seems more open, but on the condition that the private sector funds innovation.

On the Democratic side, Hillary Clinton's manifesto has the advantage of going into greater detail on her commitment should she win. To sum up, on climate change, she actively supports the EPA's Clean Power Act, and intends to build 500,000 solar panels to reduce greenhouse gas emissions.

Hillary Clinton's manifesto seems the most likely to be implemented from 2017 onwards

The elections on 15th March will probably give us a hint on the names of each party's final candidate, but for the time being, it looks like we are heading for a final showdown between Clinton and Trump.

Some observers predict a landslide victory for Hillary Clinton, should it come down to her and Trump. The future of US infrastructure is therefore closely linked to her manifesto.

Currently, her manifesto sets out a US $275 billion increase in public spending on a federal level. This would be matched by private funding, taking the total to US $500 billion.

Private funding would be partially generated by the work of a new bank created specifically to finance infrastructure. The role of this government bank will be to finance investments in energy, water, transport, broadband, etc.. President Obama's "Build America Bonds program" will also make a comeback.

Ms. Clinton's global job creation strategy is based on mass investment in reconstruction projects that will make the US economy more productive and more competitive.

The issue of the state of infrastructure in the United States is of national importance, and requires structured, national solutions. A government commitment to providing such solutions would have the added advantage of providing a motivating, clear strategy for the long-term.

The lack of investment in infrastructure is damaging American competitiveness

The United States has under-invested in its infrastructure over the last few decades, to such a degree that federal investment in infrastructure is barely half what it was 35 years ago as a percentage of GDP.

US workers and businesses drive economic growth, but neglecting infrastructure investment is preventing these growth drivers from running at full steam.

This dimension of growth is increasingly important in a globalised world in which countries such as China are pouring limitless investment into developing infrastructure able to create the perfect production environment to meet the needs of tomorrow.

In the wake of the G20, China promises more support for global growth

Over the last few days, Chinese Prime Minister Li Keqiang stated that the government was to make further investments, and set out further infrastructure spending to intensify measures to boost the economy. This will make the GDP growth target of +6.5% to +7% in 2016 more credible, but comes at the cost of increasing the public deficit to +3%, pushing it to US $330 billion.

Good news comes in the form of the 13th 5-year plan (2016-2020) setting out high levels of infrastructure spending. The Chinese government intends to commission around twenty hydraulic structures, large-scale nuclear projects, electricity production plants and oil pipelines, taking a US $100 billion chunk out of their budget annually. The size of the road network should increase from 19,000 km to 30,000 km, and 50 new passenger airports should be built. This wave of infrastructure projects is supported by the Shanghai G20 summit on boosting global growth.

A radical change in US strategy would help boost the global commodity cycle

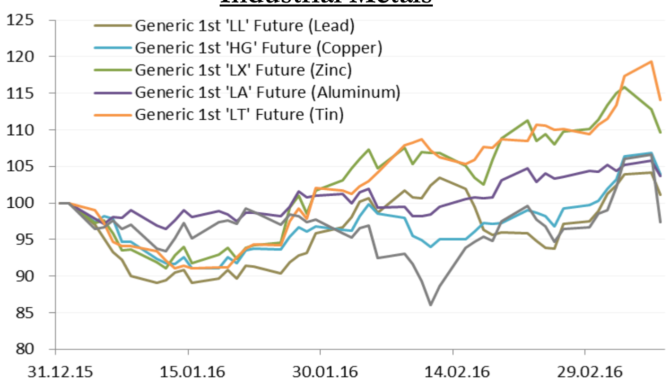
A radical change in government strategy in terms of renovating and improving infrastructure in the United States would help boost a new commodity cycle.

An increase in demand in the largest global economy would boost global demand for commodities, which has until now been propped up by the economic trend in the 2nd largest world power, China. Given that Chinese growth levels were worrying investors, and even pushing up speculation and feeding a downward trend in commodities, the Chinese Prime Minister's statements at the beginning of March setting out a more positive outlook for the sector could not have come at a better time.

Nevertheless, it is clear that a serious plan to boost infrastructure investment in the USA would change investor psychology, as the plan would be long-term, and viewed as essential for employment development and economic growth policy.

These considerations may in part already be starting to nudge the prices of industrial metals.

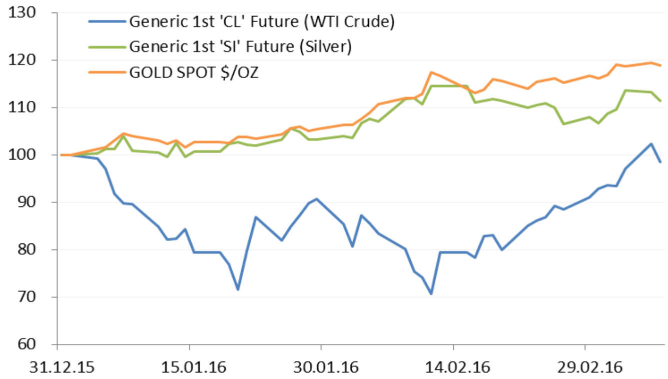
Industrial Metals



Sources: Bloomberg, BBGI Group SA

Tin (+31%), zinc (+23%), copper (+17.5%), lead (+17%), and aluminium (+8%) seem, along with other metals, to already have hit their low point; their prices have been on the rise since January. Crude oil prices have bounced back by +40% since their lowest point on 11th February, and there have been increases in gold (+20%) and silver (+12%) prices, making commodity indices stand out from the crowd.

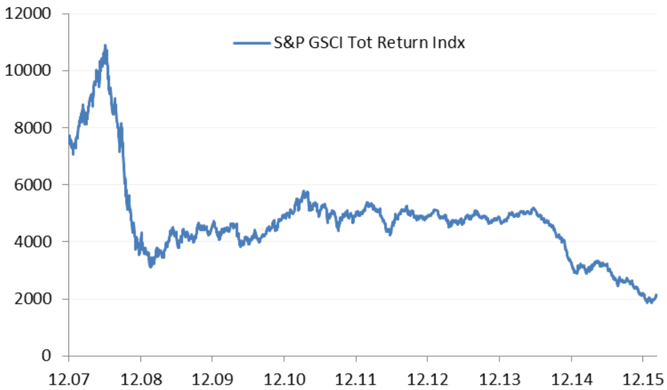
Crude Oil, Silver and Gold Bounce Back



Sources: Bloomberg, BBGI Group SA

Globally, the S&P Goldman Sachs Commodity Index has dropped -80% since its peak in June 2008, but is likely now reversing the downward trend.

Downward Trend for Commodities 2008-2016



Sources: Bloomberg, BBGI Group SA

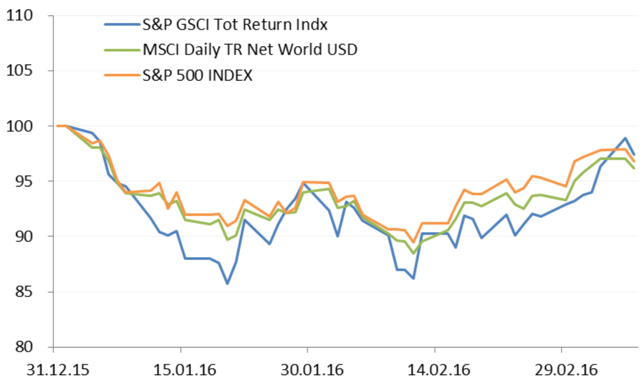
Whilst the difference in terms of performance of this index and US equities over four years is at its highest ever (126%), we believe relative performance prospects for commodities to be very attractive at the start of 2016.

Commodities, US and International Equities

Sources: Bloomberg, BBGI Group

As such, in the shorter term, after having slipped almost -15% in the first three weeks of January, to most people's surprise, commodities are now back on positive ground.

Commodities, US and International Equities

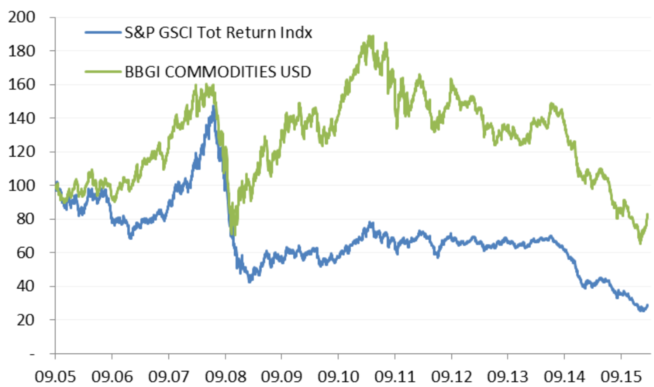


Sources: Bloomberg, BBGI Group SA

Investing in commodities requires specific expertise, which we provide for our clients in various forms, particularly via our BBGI Commodities USD Fund since it was created in 2005.

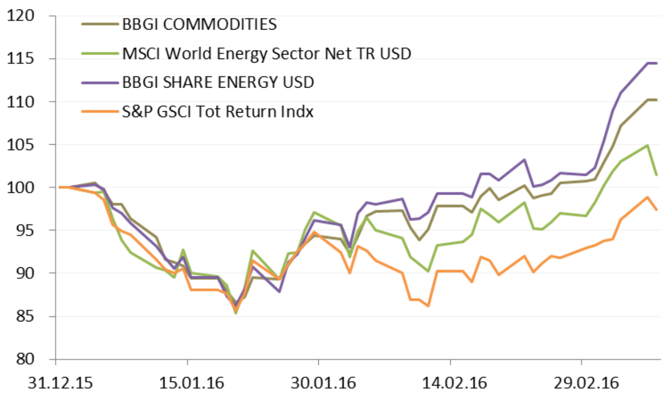
Since it was created, this fund has posted +9%/year outperformance compared to the S&P Commodities Index, and has already recorded a comfortable +11% (index -1%) since the start of the year.

BBGI Commodities USD – SPGS Commodity



Sources: Bloomberg, BBGI Group SA

BBGI Share energy USD – BBGI Commodities USD vs MSCI World energy - SPGS Commodity index



Sources: Bloomberg, BBGI Group SA

Conclusion

Infrastructure in the United States requires enormous investment, which should hit US $500 billion by 2020.

The global commodity cycle will benefit from this trend, as well as the increase in demand.

There are numerous investment opportunities, both on equity markets and commodity markets.

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