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2025 Outlook

INFRASTRUCTURE: PUBLIC AND PRIVATE INVESTMENT SHOULD PROVIDE OPPORTUNITY

INVESTMENT INSIGHTS
FROM OUR PARTNERS AT NEWTON INVESTMENT MANAGEMENT

We believe a renewed emphasis on infrastructure should provide investment tailwinds.

KEY POINTS

1. Global trends such as digitalization, electrification and deglobalization are creating significant investment opportunities in infrastructure.

2. Donald Trump has pledged to bring US jobs home during his second administration via reduced taxes, lower energy costs and a rollback of regulations for manufacturers that make goods on US soil.

3. Artificial intelligence (AI) is providing investment tailwinds beyond the technology sector as the race for computing power is expected to influence infrastructure, utilities, industrials and nuclear power.

4. An allocation to infrastructure may also enable investors to better position their portfolios to navigate near-term volatility driven by macro factors such as global geopolitical turmoil, elevated inflation and higher interest rates.

Rebuilding the physical economy in the US — including improving and repairing infrastructure, expanding manufacturing capacity and accelerating homebuilding — has become a topic of increasing consensus across both the public and private sectors. We believe both public and private investment and policy changes should continue to accelerate this trend.

Geopolitical disruptions are also driving companies to re-evaluate supply-chain priorities. Covid-19 shutdowns, the war in Ukraine, the Israeli-Hamas conflict and increasing tension in Asia have prompted companies to consider reshoring and near-shoring as insurance against further potential disruptions.

With the rise of artificial intelligence (AI), rapid development of related technologies should affect the operations of many critical infrastructure assets and industries. Data centers, for example, will be required to provide the infrastructure to store and transmit the proliferation of data-supporting AI tools. To put this in context, recent analysis shows that a simple ChatGPT query takes three to 36 times more energy than a similar Google search, reinforcing the impact that AI innovations may have on one part of the infrastructure value chain.

While we believe that infrastructure is compelling for investors in most market conditions, today's investment climate appears to be particularly rife with opportunity.

Trump 2.0

We remain optimistic about infrastructure investing following the US presidential election, which saw Donald Trump return to power. His administration is expected to extend tax cuts, implement pro-growth policies and relax regulations. Trump's economic plan includes a "manufacturing renaissance" with low taxes and minimal regulation to attract foreign companies. We believe he may prioritize infrastructure to bring jobs back to America and boost US competitiveness in the global supply chain, potentially inspiring similar actions in other nations.

Many of the megatrends and tailwinds bolstering infrastructure appear likely to continue regardless of the composition of the US government. Companies throughout the US infrastructure value chain are just beginning to see benefits from the significant public and private investments flowing into the industry, and we expect that momentum to continue. From roads, airports and bridges to manufacturing facilities, broadband internet and renewable energy, we believe that modernizing US infrastructure presents numerous and diverse opportunities for investors to consider for the long term.

US manufacturing remains a clear area of political consensus, with both Democrats and Republicans indicating "net favorable," meaning a larger percentage of both parties rated the manufacturing industry as favorable versus unfavorable; plus 27% for Democrats and plus 53% among Republicans.[1] In our view, the potential for supportive policies and bipartisan agreement at multiple levels of government leaves US manufacturing poised for continued growth.

Existing Legislation Still Has Legs

Reshoring, the practice of bringing manufacturing back to domestic locations, gained momentum during the pandemic as global trade faced significant disruptions from supply-chain bottlenecks. By boosting domestic production and simplifying supply chains, businesses and governments can enhance control and mitigate risks associated with previously complex and fragile systems. Recent legislation, including the Infrastructure Investment and Jobs Act (IIJA), the CHIPS and Science Act, and the Inflation Reduction Act, aims to accelerate reshoring efforts by allocating billions of dollars to bolster transportation infrastructure and support semiconductor and electric-vehicle (EV) manufacturing. As a result, semiconductor companies have announced over 80 new US-based projects, representing nearly $450 billion in private investment — clear evidence that these policies are driving tangible outcomes.

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Three years into the implementation of the IIJA, its impact is already evident: more than 60,000 construction projects have advanced, repairs are underway on 175,000 miles of roadway — enough to span the US 60 times — and over 10,200 bridge-modernization projects are in progress, with many others in development nationwide.[2] With $720 billion in IIJA funds yet to be allocated, there remains substantial potential for further infrastructure investment as projects transition from planning to construction.[3] Semiconductor firms have since announced over 80 new projects in the US, amounting to nearly $450 billion in private investment, a sign that these polices are having an impact. We believe additional policies could emerge following the 2024 elections to further accelerate reshoring.

Energy and AI

Two major trends, digitalization and the energy transition, are converging. Data centers and other large-scale power users are starting to have trouble sourcing enough electricity for their operations. Supported by transformative technologies like AI, the increased demand for data creates a compelling backdrop to invest in the hard assets enabling the digital ecosystem. This starts with data centers, but also includes fiber-optic networks, wireless towers and other assets.

Large-scale investment in both power generation and transmission will likely be needed to solve the digital power problem, along with new technology and creative solutions. We believe this could lead to an increase in energy-transition investments and technologies, as well as continuing opportunities in conventional energy. Digitalization, the energy transition and the digital-power problem are massive challenges that require scaled capital and deep sector expertise to solve but also present a tremendous investment opportunity to those with the ability to solve them.

We continue to see the AI beneficiaries broaden out. The advancement of AI is a global competition supported by massive amounts of capital flowing into the AI ecosystem. No matter who wins, those supporting the build-out are likely to be the true beneficiaries. The AI build-out adds another tailwind for electric utilities companies, infrastructure firms and industrials companies that are already benefiting from the global trends of electrification and deglobalization.

[1] Visual Capitalist, "How Do Democrats and Republicans Feel About Certain U.S. Industries?," 2/19/24.

[2] US Department of Transportation. "U.S. DoT Celebrates Biden Administration's Progress Delivering on the Bipartisan Infrastructure Law," 09/18/2024.

[3] US Department of Transportation and Construction Dive. "$720B in IIJA funds yet to be allocated," 09/19/2024.

We recently met many industry management teams, which increased our conviction and confidence in the opportunity while confirming the heightened demand for electricity from hyperscalers. The management teams also continue to see intensified activity from the onshoring of manufacturing activities, which has a multiplier effect around the locations of the infrastructure build-out, which we did not fully appreciate previously. We believe the confluence of these three forces (AI, onshoring, electrification) should continue to drive increased demand and activity for infrastructure companies, leading to continued appreciation of the securities in this space.

Favorable Valuation

We feel the environment remains positive for infrastructure with many tailwinds in place. Over the past five years through September 30, 2024, infrastructure stocks have underperformed global equities by over 40%, but current trends could help close this gap. In our view, the demand for electricity from the electrification, deglobalization and AI data centers should continue to support sentiment and drive higher revenue growth for infrastructure securities. Within the US, the utilities sector has returned 30.6% over the nine months to September 30, 2024, outperforming both the S&P 500® and the information technology sector, but has still underperformed the S&P 500 by over 60% over the trailing five years through September 30, 2024. Independent power producers continue to benefit from news of power deals with hyperscalers, including recent news about several large technology companies' potential to strike a partnership. Investors continue to bid up the power producers on the outlook for prospective deals, which some believe are being agreed to with power prices double their current levels.[4]

US Infrastructure: A Promising Future

The outlook for US infrastructure appears promising, driven by historic public and private investments. Federal initiatives like the IIJA, CHIPS Act and Inflation Reduction Act are funding projects across transportation, clean energy and broadband, while nearly $1 trillion in private investments supports these efforts. Challenges such as funding shortfalls, workforce shortages and regulatory delays persist, but opportunities for job creation, economic growth and improved quality of life make the future of US infrastructure appear optimistic.

[4] Bloomberg News, "Blackstone Is Building a $25B Empire of Power-Hungry Data Centers," 1/30/24.

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Hyperscalers are large-scale data-center companies that provide massive amounts of computing power and storage to organizations and individuals globally.

Infrastructure stocks are measured by the S&P Global Infrastructure Index and global equities are measured by the MSCI World Index. The **S&P Global Infrastructure Index** is designed to track 75 companies from around the world chosen to represent the listed infrastructure industry while maintaining liquidity and tradability. To create diversified exposure, the index includes three distinct infrastructure clusters: energy, transportation, and utilities. The **MSCI World Index** is a free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed markets. An investor cannot invest directly in any index.

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