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U.S. Infrastructure After the Nov. 3 Elections

Andrew Hsu and Damien Contes | September 2020

Entering the 2016 election year, Washington seemed on the cusp of launching the first major federal infrastructure spending initiative since the construction of the interstate freeway system more than a half-century ago. Then hyperpartisanship overwhelmed Capitol Hill, including the divisions around special counsel and congressional investigations of President Donald Trump, and the White House tabled plans in May 2019 for a $2 trillion spending package on infrastructure.

The outcome of this year's presidential election could at last open the way to massive federal infrastructure spending. Both President Trump and Democratic nominee Joe Biden are proposing large-scale infrastructure programs. However, what form federal spending will take depends on what happens on Nov. 3, especially given significant differences between the policy priorities of the Trump and Biden administrations.

The Trump administration advocates for fossil fuels, which it regards as key to America's energy independence. Implementation of regulatory changes such as easing of emission standards has acted as both a measure to slow the demise of the coal industry and promote growth of newer technologies in fossil fuel extraction (fracking, offshore, et al.). Although unsuccessful in pushing through major public-works spending, the White House has slashed regulations to pare timelines for infrastructure projects (key to encouraging private capital to invest alongside public expenditures in these projects). In contrast, Democrats are advancing "sustainable infrastructure." This approach foresees a "net-zero emissions economy" by 2050.

If gridlock gives way post-Nov. 3 to large-scale federal infrastructure investment in partnership with private capital, the DoubleLine Infrastructure Income Fund (I shares BILDX, N shares BILTX) is ready to pursue those opportunities. Whether policy is driven by Republicans, Democrats or some compromise between the two parties, DoubleLine's Infrastructure Income team has experience and expertise investing in project debt, corporate debt and securitized debt of traditional and new-economy infrastructure projects.

We will review these policy differences after setting forth the general case for an ambitious public-works initiative by the U.S. government and the place for private capital to participate in these projects.

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The Case for a National Upgrade of U.S. Infrastructure – for the Long Term and Post-COVID-19

The case for such an initiative was clear four years ago. The federal government and the states have allowed the country's backbones for transportation, energy and electrical power and other traditional infrastructure to deteriorate to the point that the American Society of Civil Engineers grades the national infrastructure a D-plus. In addition, the economy needs investments in renewable energy, 5G networks and other new-economy technology.

Furthermore, the COVID-19 economic lockdowns have saddled the U.S. with Depression-level unemployment. Public-works projects are labor-intensive, providing both large numbers of transitory jobs during design and build-out, and long-term employment for the operation and maintenance of these long-lived assets. Provided infrastructure projects are well planned and executed, infrastructure spending can grow the economy, create employment and increase productivity. Along with these benefits, infrastructure spending is even more compelling when coupled with unprecedented low interest rates at which the federal and state governments could borrow.

Infrastructure Debt as an Investment Opportunity

Even in the event that Washington appropriates federal funds for public works on a large scale, this will not cover infrastructure needs at the state and local levels. While more regulatory reform is needed to reduce design and build-out timelines to attract private capital, private institutional investors have already moved into the sector to help address the funding gap.

In the past, many individual investors have viewed infrastructure debt as an esoteric fixed-income asset class available only to institutional investors. DoubleLine has actively managed infrastructure debt securities in multisector and asset allocation portfolios since August 2015 and the DoubleLine Infrastructure Income Fund since its inception in April 2016.

During economic downturns, infrastructure debt has maintained lower default rates, less credit rating volatility and higher recovery rates. Backed by long-lived tangible assets, the cash flows have a higher degree of predictability than comparable investment-grade corporate debt due to project contracts. Thus, we believe infrastructure debt should be considered when constructing a diversified fixed-income portfolio.

Republicans, Democrats and Infrastructure

President Trump has proposed a $1 trillion spending package targeting roads, bridges, water systems, 5G networks and rural broadband. Former Vice President Biden has proposed a $2 trillion spending plan to restore highways, roads and bridges; increase adoption of electric vehicles and trains; and develop 5G networks and renewable energy.

Renewable Energy. Democrats have laid out specific agenda items for their clean energy program, including a pledge to eliminate carbon emissions from the electricity sector by 2035. About 37 percent of U.S. electricity generation came from zero-carbon sources in 2019, according to data published by the U.S. Energy Information Administration on its website. In order to reach its carbon-free objective, Biden's administration would include solar, wind and other forms of "clean" energy, such as nuclear, biomass and hydropower, that do not always qualify under states' renewable portfolio standards. In contrast, the Trump administration has been reluctant to support green energy infrastructure and instead has championed coal as clean and efficient. We view this as an opportunistic sector as the adoption of renewable energy has grown significantly over the last several years.

We have been investing in solar mainly through structured products, and in wind through corporate and project bonds. Our solar projects are U.S.-centric; our wind projects are located in the U.S. and Latin America.

Traditional Power and Energy. The Republicans' agenda favors fossil fuels as the means of achieving the "energy dominance" called for by President Trump. They seek to relax stringent emission standards and climate change policies that have hampered the growth of traditional U.S. energy infrastructure. Onshoring of U.S. manufacturing will likely further drive the need for energy build-out should there be a large-scale return of U.S. manufacturing and a renaissance of U.S. industrialization. In contrast, Democrats have pledged to sunset traditional power and energy in favor of renewable energies. We are constructive on the power and midstream energy sectors. However, we remain cautious on exploration and production assets as the commodity-driven energy sector tends to be more volatile.

Our focus in the power sector is largely through integrated utilities, gas and oil midstream, transmission and distribution. Our integrated utilities and oil midstream investments are U.S.-centric; our gas midstream, transmission and distribution investments are a mix of U.S. and Latin American opportunities.

Telecom. Both major political parties support developing 5G technology and repurposing spectrum bandwidth to accommodate it. 5G will offer faster (about five times faster than 4G) and more-stable mobile connections. This technology will engender wider adoption to the IoT ("internet of things") and will have profound consequences. Significant spending will be required to bridge the gap between what is available domestically versus advancements made internationally, notably China. We see tremendous growth potential in telecom infrastructure as society becomes increasingly reliant on these assets.

Access to these investments is done through structured products, and corporate and project bonds. The Fund has been focused in adding exposure to data centers, wireless towers and wireless providers. The entirety of our telecom exposure is housed in the United States.

Transportation. The 2015 Fixing America's Surface Transportation (FAST) Act is about to expire. The Trump infrastructure plan is built around the act's renewal and calls for $810 billion for highway and transit projects over a 10-year period. The Biden plan promises to "[t]ransform our crumbling transportation infrastructure – including roads and bridges, rail, aviation, ports, and inland waterways." Both plans are vague and lack useful details for investment consideration. The transportation sector has been the most impacted by the stay-at-home orders in response to the COVID-19 crisis. We continue to monitor the opportunities in this sector.

Maritime shipping, aviation and rail investments are made through structured products, with a focus on the most-senior tranches. Airport, port, road and railroad investments comprise a mix of corporate and project bonds. Geographically, the Fund has exposure to ports in Asia, airports in Australia, railroads in the U.S. and Latin America, and toll roads in Latin America.

Conclusion

During past elections, "infrastructure" has been a political buzzword, often representing grandiose ideas without a clear road map or financing plan. Despite the lack of public spending on infrastructure, everyone's quality of life improves when we have reliable power sources, dependable telecom networks and sound transportation systems. The COVID-19 pandemic exposed weaknesses in domestic and global supply chains, illustrating the importance of strong infrastructures in maintaining the strength of our economy.

We remain hopeful for some compromise by the parties to pass an infrastructure bill. It would be beneficial to the citizenry and economy at a time when a plan is critically needed. At DoubleLine, we have identified and acted on very attractive targets in the private infrastructure sectors across various asset classes and industries. The opportunities in the infrastructure space are already very abundant, a rekindling of federal and state spending would only expand them. ■

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Author Biographies

Andrew Hsu, CFA
Portfolio Manager
Asset-Backed Securities

Mr. Hsu joined DoubleLine at its inception in 2009. He is a portfolio manager for the DoubleLine Total Return and ABS/Infrastructure Income strategies. Mr. Hsu is a permanent member of the Fixed Income Asset Allocation and Structured Product Committees. Prior to that, he was responsible for analysis and trading of structured products where his focus included Residential MBS and ABS transactions. Mr. Hsu's responsibilities have also included structuring and negotiating terms on new issue transactions and forming strategic partnerships with issuing entities in order to participate in key transactions. Previous to DoubleLine, he joined TCW in 2002 where he focused on credit analysis for structured product securities and co-managed two structured product funds focusing on debt and equity investments. During this time, Mr. Hsu was actively involved with portfolio management decisions and investment analysis, including reverse engineering complex CDO/CLO structures. He holds a BS in Finance from the University of Southern California and is a CFA® charterholder.

Damien Contes, CFA
Portfolio Manager
Global Infrastructure Investments

Mr. Contes joined DoubleLine in 2013. He is a Portfolio Manager on the Global Infrastructure Investments team. Previously, Mr. Contes' responsibilities included coverage of the following infrastructure sectors for the Emerging Markets Fixed Income group: transportation, oil & gas, petrochemical. Prior to DoubleLine, he spent six years with ICE Canyon, LLC where he served as a Corporate Research Analyst. At ICE Canyon, his credit work contributed to the investment management of the firm's three types of Emerging Markets and global vehicles: hedge fund (absolute return), index products (relative value) and collateralized loan obligations (CLOs). Mr. Contes' investment experience includes a variety of instruments, such as global leveraged loans, high yield bonds, distressed opportunities, credit default swaps, structured products and privately negotiated custom credit instruments. Previous to ICE Canyon, he was a Senior Bank Debt Specialist with Canyon Capital Advisors, where he was responsible for the settlement of foreign and distressed bank debt transactions. Prior to that, he was a Senior Fund Accountant with Mellon Financial Corporation, overseeing Emerging Markets Real Estate funds and Oil & Gas Debt and Royalty funds. Mr. Contes holds a BS in Business Administration with a concentration in Accounting & Finance from the College of Charleston in Charleston, South Carolina. He is a CFA® charterholder.

Mutual Fund Disclosure

The fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory prospectus and summary prospectus (if available) contain this and other important information about the investment company and may be obtained by visiting www.doublelinefunds.com. In addition, a free hard-copy is available by calling (877) 354-6311/ (877) DLINE11. Please read the prospectuses carefully before investing.

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References to other mutual funds should not to be considered an offer to buy or sell these securities. Diversification does not assure a profit, nor does it protect against a loss in a declining market.

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Definitions of Select Terms

Cash Flow - The net amount of cash and cash-equivalents being transferred into and out of a business.

Investment Grade - A rating that signifies a municipal or corporate bond presents a relatively low risk of default.

DoubleLine Disclosure

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