

ANALYST(S)

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Buy-rated companies mentioned in this report:

- **Boeing** (BA - \$167.53)
- **Canadian Pacific** (CP.TO - \$398.95)
- **CSX Corp** (CSX - \$79.50)
- **Deere** (DE - \$219.94)
- **Donaldson** (DCI - \$48.75)
- **Emerson** (EMR - \$69.09)
- **Honeywell** (HON - \$170.34)
- **Illinois Tool Works** (ITW - \$200.94)
- **Jacobs** (J - \$94.38)
- **Parker Hannifin** (PH - \$214.07)
- **Raytheon Technologies** (RTX - \$62.81)
- **Roper** (ROP - \$398.80)
- **Union Pacific** (UNP - \$201.65)
- **Woodward** (WWD - \$85.30)

Prices are as of market close on 9/17/20 and are subject to change. Source: Reuters.

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Investment Overview

- We believe investors can benefit by owning industrial companies that participate in new infrastructure spending in emerging economies as well as upgrading aging infrastructure in developed economies like the U.S.
- Infrastructure refers to the foundation, or building blocks, of a modern society. Examples include roads, rail lines, factories, office buildings, trains, ships, communication networks, power generation (coal, gas, wind, etc.) and transmission.
- As emerging markets develop, they need to invest in the infrastructure necessary to support their continued growth. Many types of infrastructure also tend to require additional components such as air conditioning for buildings, engines for aircraft and machinery for factories.
- Energy efficiency is a key focus of future infrastructure spending, which should benefit U.S. industrial companies that have advanced technologies and products.

Global Infrastructure Spending Is Large and Growing

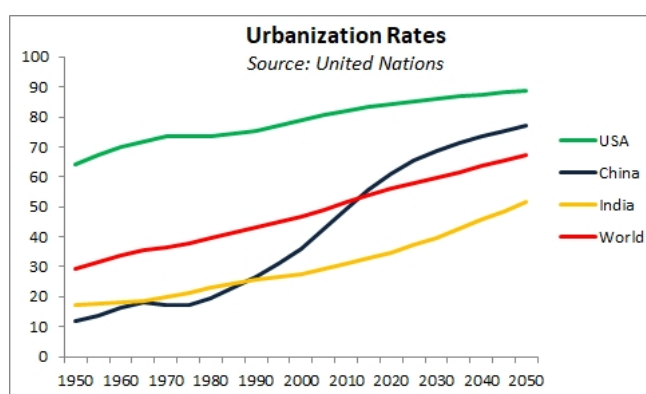
The globalization of the economy and acceleration of international trade are fueling long-term economic growth and the rise of middle class society in countries such as India and China. Emerging economies have spent heavily on infrastructure to provide a foundation for this growth. To support their goals for long-term economic expansion and rising living standards, we expect this trend to continue, on the order of \$2 trillion - \$3 trillion per year for the next decade. Spending in developed economies, such as the U.S., should also benefit from upgrading aging facilities, equipment, and transportation networks.



International Opportunity

Emerging economies are in the process of building out infrastructure to support a massive demographic shift of populations moving into cities from the countryside (**Figure 1**). Urbanization rates are considerably lower in emerging economies than in developed countries, and we expect infrastructure spending to be a top focus as those countries start to close the gap with developed economies. We think this opens up a large opportunity for U.S. industrial companies, which are already active in the emerging markets.

Figure 1



Aging U.S. Infrastructure Needs Investment

Unlike many emerging markets, the U.S. has an extensive infrastructure system that was built out over the last century. However, much of that infrastructure is aging and will need significant investment to accommodate an expanding economy and growing population. For instance, the American Society of Civil Engineers (ASCE) estimates total investment needs of \$3.6 trillion through 2020, but only expects funding of \$2 trillion given current investment trends.

Funding for infrastructure has faced challenges due to difficult economic conditions and strained federal, state, and local budgets. Inadequate infrastructure leads to higher costs for businesses and reduced competitiveness in global markets, which may result in lost GDP and employment. Given the importance of infrastructure and the potential for returns to providers of capital, we believe public and private investment will continue to grow and other forms of capital will become available. Higher taxes, foreign investment, and public-private partnerships are just a few practical solutions to raise funding.

State and local governments are traditionally responsible for approximately two-thirds of infrastructure spending in the United States but have faced budget deficit issues due to declining

tax revenues. The current economic uncertainty could lead to additional pressures on local spending. At various times, federal stimulus spending has targeted infrastructure as a method to spur growth and help repair infrastructure. While near-term funding levels are uncertain, over the long term we believe governments will allocate funding to support infrastructure improvements.

Below we outline several opportunities for U.S. infrastructure companies:

Table 1: Buy-rated Infrastructure Stocks

	HVAC	Aircraft	Energy	Manufacturing	Transportation
Boeing		X			
Canadian Pacific					X
CSX Corp.					X
Deere				X	
Donaldson				X	
Emerson	X		X		
Honeywell	X	X	X		
Illinois Tool Works				X	
Jacobs Engineering			X	X	
Parker Hannifin		X		X	
Raytheon Tech.		X			
Roper					X
Union Pacific					X
Woodward		X	X		

Source: Edward Jones

Heating, Ventilation, Air Conditioning

Heating, cooling, and ventilating America's buildings has historically been one of the largest sources of energy demand. With new energy efficient HVAC (heating, ventilation, and air conditioning) systems now available that can reduce utility bills in a short period of time, we expect many existing commercial and residential building owners will choose to upgrade their systems over coming years. We believe Honeywell and Emerson are companies that could benefit from pent-up demand for replacing the nation's aging HVAC equipment. They also supply technology to help lower energy usage.

Aircraft

Air travel is a well-entrenched part of the American economy but many of the nation's planes are aging and in need of replacement. Older planes are less fuel-efficient than newer aircraft, which can make it harder for airlines using older planes to turn a profit with jet fuel accounting for roughly one-third of an airline's expenses. Although the coronavirus has impacted near-term passenger traffic and aircraft demand, we believe airline travel will improve over the next several years. In our opinion, this will lead to airlines around the world adding planes to their fleets, helping plane manufacturers such as Boeing and aerospace suppliers like Raytheon Technologies

(engines, landing gear, etc.), Honeywell (avionics - the technology used by pilots), Woodward (engine systems and motion control), and Parker Hannifin (hydraulics).

Energy Infrastructure

The U.S. is gradually becoming more self-sufficient in meeting its energy needs, thanks to new drilling technology and promising oil and gas finds. Many industrial companies provide important technology to support the build-out of the nation's energy infrastructure, including Emerson (values and measurement equipment used in the oil & gas industry, automation for energy facilities), Honeywell (automation for energy facilities, catalysts utilized in refining), Jacobs Engineering (builds and maintains refineries and petrochemical plants), and Woodward (power generation and conversion).

Manufacturing

The U.S. is also seeing the return of some manufacturing jobs, due to rising wages in competing economies and improved productivity in America. Companies we think could benefit from increased manufacturing include Parker Hannifin (motion controls and machinery), Donaldson (filtration for manufacturing processes), and Illinois Tool Works (manufacturing tools and equipment). Jacobs Engineering looks well-positioned to benefit from new manufacturing facility construction, which is on the rise. In addition, demand for Deere's construction machinery should benefit from both increased construction activity and highway maintenance and improvements.

Transportation

Poor road conditions and congestion impose real costs on the nation's economy, leading to lost productivity and higher transportation costs. Roper helps alleviate roadway congestion with its traffic management solutions and toll road technology, both of which become more important as government budgets have less room for expanding roadways to accommodate more passenger cars and increasing trucking volumes.

Private railroad investment has picked up and will likely continue to grow as freight volumes have increased, partly due to the resurrection of American energy production. Furthermore, as freight demand grows, so does the popularity of freight containers (intermodal). Rails are a major component of intermodal freight, helping to increase efficiency and lower costs when compared with standard truck freight. The railroads that we think could benefit from these trends are CSX Corporation, Canadian Pacific, and Union Pacific.

Investors Can Benefit by Owning U.S. Companies

We expect new infrastructure spending will largely take place overseas, but there is also a substantial opportunity for replacing aged and outdated infrastructure in the U.S. Many of the industrial companies we follow should benefit from spending in both developed and emerging economies, as U.S. industrial companies have many of the high-technology solutions that companies in emerging market economies typically cannot offer.

Risks

In the near term, protectionism in regards to trade could be a risk to manufacturers. Recently, countries have elevated the level of discussions on tariffs and other trade restrictions as they feel these actions could protect their domestic workforces during economic challenges. If broad restrictions are put in place, the ability of industrial companies to sell products abroad could be negatively impacted.

In the long run, we believe that another risk will be an increasing number of competitors, especially from countries such as China. Like Japan and South Korea in past decades, China's government is currently shifting policy away from lower-end manufacturing to high-technology industrial and consumer products. Heavy government support and the availability of engineers and labor could produce viable Chinese competitors in various industrial sectors more rapidly than expected.

Finally, while we do expect strong long-term growth in infrastructure spending, there will certainly be economic up-cycles and down-cycles over time. This would lead to fluctuations in demand for the various products and services involved.

Valuation

Methods we use to evaluate the attractiveness of industrial stocks include traditional ratios such as price-to-earnings (P/E) and price-to-sales (P/S), both on an absolute and relative basis, PEGY ratios (P/E vs. estimated growth and dividend yield), and discounted cash flow (DCF) analysis.

Please see your financial advisor and read the individual company research reports, which contain additional information on valuation and risks, to see which stocks are appropriate for you and are good values at their current price.

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