File # 210026

Silchester:

1) **What holdings (and what percentage), if any, in your portfolio might benefit from any US Infrastructure Bill if it were to pass?**

We perform an annual review of the Portfolio geographic exposure. At the end of 2019 around 18% of portfolio revenues were generated in the US. The sector which would most likely benefit from the Infrastructure Bill would be our Japanese Industrial businesses which have operations in the US. This would include companies such as ***Maruichi Steel Tube,*** (0.3% portfolio exposure) which makes steel pipes for the construction market, also ***Toyota Industries,*** (1.1% portfolio exposure) which manufacturers materials handling equipment, ***Mitsubishi Materials***, (0.9% portfolio exposure) an industrial conglomerate producing cement, copper, aluminum & cemented carbide products & sintered parts and ***Sumitomo Heavy***, (1% portfolio exposure), a manufacturer of industrial machinery. Our estimates suggest that the revenues generated from these businesses in the US would not be considered material in the context of the entire Portfolio but certainly not insignificant.

2) **What is the confidence level (either from you or if you have gotten an indication from management) of your portfolio of companies that they would be able to pass on any input price increases they may face in the near future?**

Following the peak of the pandemic last year, we have noted that many European manufacturers are either fully or partially passing through higher input costs as a shortage of materials and rising shipping costs disrupt supply chains. Input prices for Eurozone manufacturers have risen to their highest level in a decade – this is being felt hardest in autos, chemical, metal, mining and resource sectors.

There are also higher handling and administration costs for trade between the UK and Mainland Europe as a result of Brexit. In the short term some of these have been absorbed but consensus seems to be that this will ultimately be paid for by the consumer.

In Asia, shortages of many products such as semi-conductor chips has resulted in production being cut back. Globally consumers are facing price rises and shortages of products including TV's, mobile phones, laptops, notebooks and autos. Efforts to cushion increasing costs have been restrained as supply chain bottle necks are unlikely to ease in the short to medium term.

DGI:

1) What holdings (and what percentage), if any, in your portfolio might benefit from any US Infrastructure Bill if it were to pass?

We are pleased to respond to your questions within the context of our investment process, which resides at the individual company level. We develop a granular, highly specific seven-year forecast for every holding. We update our forecasts regularly. One of our areas of focus is the size of addressable market for the products or services offered by each company. While we could reasonably forecast that an infrastructure plan might temporarily speed up near-term revenues, we would have to conclude that the spending would be sustainable and our companies could earn reasonable profits and ROC capital requirements from such customers. That is, we would be examining whether the infrastructure bill would sustainably increase the size and sustainable profitability of the addressable market with reasonable odds before we would include its effects on our forecast on any of our current holdings.

We also note that we do not generally attach much meaning to possible changes in government spending until the legislation is actually passed. Further, we note that an infrastructure bill passage would also likely bring with it an increase in corporate income tax rates. All other thing being equal, the 2017 corporate tax rate decrease increased the expected return on our stocks. If the tax code were changed to increase corporate tax rates, all other things being equal we would forecast that the expected return on our stocks would decline. We note that "all other things being equal" rarely happens.

2) What is the confidence level (either from you or if you have gotten an indication from management) of your portfolio of companies that they would be able to pass on any input price increases they may face in the near future?

In general we seek to invest in companies which offer a strong value proposition to their customers. That is, our portfolio holdings price their products off of their value-added, not their costs. Our portfolio holdings are generally very focused on pricing their products fairly. If any of our companies were to experience significant cost-push inflation in the future, we would expect they would absorb some of the cost increases and pass some on to their customers, consistent with maintaining a long-term value-added proposition with their customers.

We also note that inflation has not yet accelerated in a meaningful way.

<u>Brown:</u>

1) What holdings (and what percentage), if any, in your portfolio might benefit from any US Infrastructure Bill if it were to pass?
   For the most part our holdings would benefit indirectly as we don't own engineering, building or heavy industrial names. IEX, CTAS, ADSK, ROP which is about 11% of portfolio would likely benefit in some way from increased infrastructure spending.
2) What is the confidence level (either from you or if you have gotten an indication from management) of your portfolio of companies that they would be able to pass on any input price increases they may face in the near future?
   None of our portfolio holdings is a commodity driven business model so they all have the ability to increase pricing whether that comes from cost increases or otherwise. Of the companies that we own that are a bit more sensitive to input price increases BF.B ,SHW, EL, COST, CTAS, NXPI all have shown the ability to pass along cost increases and are confident they will be able to do so going forward.

<u>BH:</u>

Given our large overweight to industrials and several materials stocks, we will have meaningful exposure to the bill. While many of the companies will see a direct benefit, the secondary benefits to other companies will have an impact as well. As roads, highways, bridges, etc. are being bid out, the companies will need to make additional capital investments in equipment, employees, technology and higher employment will have knock-on effects for the entire economy. We believe that capital expenditures are expected to increase approximately 15-18% above 2019 trend by the year 2022. Some from pent up demand and some from new assets flowing into the industry (infrastructure spending, increased state tax revenues). We also see this shaping up around the world that will likely cause another commodity super-cycle starting 3 or so years from now given the underinvestment in many areas. So we will be watching not only for the immediate impact of spending, but the knock-on effects for other industries (basic materials, energy, certain metals and aggregates).

In addition to the above, other comments to add are:

The portfolio has about 65% in securities that will be direct beneficiaries to the bill in some form or another. Additional securities will have small trickle-down effects as well. The bottom-line is that the bill will increase demand for the products, output, commodities and services of many of our companies. While many of those securities have had a meaningful move off the bottom, they will all still have meaningful upside considering that management's are expecting to spend more in cap-ex and more on hiring employee's than they have in many years. They also expect to see sales and earnings growing 15-20% above the pre-pandemic levels and significant pricing power as demand outpaces supply in many areas. One example is that energy companies will be facing a massive increase in demand in the next two years that will not be reached at current levels of production. World oil demand is expected to increase to 106 million barrels per day in the next year, only reaching the last high in 2019, and will increase at the rate of global GDP, so around 5-6% for the next 3 years. Increased valuations will likely follow given the scarcity of some of the resources.

Baillie Gifford:

What holdings (and what percentage), if any, in your portfolio might benefit from any US Infrastructure Bill if it were to pass?

This is an international portfolio so the underlying operating exposure to the US market is relatively limited. For example, as at June 2020 the Fund's underlying revenue exposure to the US economy was 12.2%, vs 17% in the MSCI ACWI ex US Index. Clearly some holdings will have a greater exposure to the US economy than others, but in the most part these companies are not operating in parts of the economy that will be affected by the Infrastructure Bill.

What is the confidence level (either from you or if you have gotten an indication from management) of your portfolio of companies that they would be able to pass on any input price increases they may face in the near future?

This is an international portfolio and most of the holdings are operating on a global basis, or at least across multiple markets, as such this portfolio will be exposed to a range of inflation environments over the coming year.

Having said that, our confidence in the ability for the portfolio companies to pass on input costs is high. The portfolio has been built with companies that are typically asset/inventory light but with strong competitive positions, which confers pricing power. Examples would be platform companies such Alibaba, Mercadolibre, Meituan Dianping and Zalando, that have large market shares, loyal customers and unit prices that are set by the underlying vendors. Elsewhere, the portfolio is tilted towards software and healthcare companies where material input costs are negligible and consumer loyalty and switching costs are high. Luxury holdings such as Kering (3.9%) and Ferrari (4.3%) do have input costs, but brand loyalty is strong and the margin structure in these businesses mitigates the cost impacts. Finally, there are a small group of stocks where raw materials are a significant cost; e.g. BASF (0.7%) in chemicals, Stellantis (0.9%) in autos, Inditex (2.0%) in fashion, Nidec in electric motors (2.1%) and Atlas Copco (1.8%) in industrial equipment, but most of these businesses are in a good position to pass costs on quickly. Experience tells us it tends to be the service companies or consultancy companies who tend to aggressively price contracting services, often at breakeven or at a loss, in the hope of tagging on additional services at the back end, who have been hurt in the past when inflation rises and they can't reprice their contracts upwards. The holdings mentioned above should have good visibility into real time pricing in the market and can quickly change prices upwards to respond to inflationary pressures.

TWIN:

1) What holdings (and what percentage), if any, in your portfolio might benefit from any US Infrastructure Bill if it were to pass?

Admittedly it is a bit difficult to directly attribute the impacts of the infrastructure bill as it is not yet finalized. As you know, President Biden will be here in Pittsburgh this afternoon to push his $2.25 trillion infrastructure plan.

To address the PRC's question, given the unknowns of the specifics of the bill at this point we only concentrated on the directional nature of the infrastructure piece and focused on the stocks currently held in the City of Gainesville **Prime** account. We tried to identify securities that would be directly affected by the spending such as Industrials, Materials, Energy, and Utilities. We also included some additional securities that could benefit such as PLD (Industrial REITS), GM (Consumer Discretionary) due to increased work trucks, TSLA (Consumer Discretionary) electric grid, as well as others. We did not include all Industrials such as airlines because it is unclear if there would be a direct relationship. The result of our analysis is that there are 48 of 183 names held representing 22% of the portfolio that would directly benefit from the bill.

Lastly, there are sectors that will indirectly benefit, but we did not include them among the 48 stocks. For example, many Financials companies could benefit indirectly from the Infrastructure Bill such as insurance companies and banks as the yield curve will probably continue to steepen.

2) What is the confidence level (either from you or if you have gotten an indication from management) of your portfolio of companies that they would be able to pass on any input price increases they may face in the near future?

As a quantitative manager, TWIN does not speak to company management. However, we have conducted research on the impact of inflation on different type of stocks which helps address your question about the ability of companies to pass on any input price increases to their customers. Please see the attached for our analysis of the impact of rising inflation, stable inflation and decreasing inflation on various asset class returns. In terms of equities, we evaluate the S&P 500 based on their dividend history -- those stocks that consistently grow their dividend payments and those stocks that do not pay dividends at all. We also include bonds and commodities in this analysis to compare the impact of increasing, stable and declining inflation on the two groups of stocks, the S&P 500 overall and the two other asset classes. We define rising inflation when the change in the annual inflation rate increases by 0.75% or more over the most recent 6-months and declining inflation when the change in the annual inflation rate over the previous 6-months decreases by 0.75% or more.

The bottom line is that for the past 40 years, the S&P 500 index provides its highest average return in months with falling inflation and its lowest average return in months with rising inflation. As you would expect, bonds perform best in stable inflationary environments while stocks (S&P 500) perform best in deflationary environments. The non-paying dividend stocks (e.g., GOOG, FB, NFLX, etc.) generate the highest returns in months with falling inflation while consistent dividend-growing stocks (e.g., MSFT, JNJ, PG, etc.) provide the highest average return when inflation is rising. That is because many companies who consistently grow their dividend payments over time have a greater ability to pass on input price increases to their customers often because they sell products or services for which demand is less sensitive to price . As an example, customers still need to buy laundry detergent and other staples in spite of rising prices. In fact, since 1981, **companies that consistently grow their dividends** (TWIN Dividend Select Club members) **provide the highest average monthly return (0.72%) in months with rising inflation relative to other equities and bonds.** Currently, members of TWIN's Dividend Select Club represent over 40% of the City of Gainesville's **Prime** Portfolio which we believe will perform better in rising inflationary environments.

Pzena:

1.) What holdings (and what percentage), if any, in your portfolio might benefit from any US Infrastructure Bill if it were to pass?

The Biden Administration is attempting to pass an ambitious and wide-ranging infrastructure bill through Congress by the summer. The bill's present form is subject to change as lawmakers from
both sides of the aisle inevitably raise objections. That said, The White House's current proposal includes government funding for:

- Roads, bridges, tunnels, rail roads, water systems and the nation's power grids
- Transit systems
- The expansion of high-speed broadband access
  - Wireless via 5G
- Clean energy – particularly EV manufacturing
- Education, including school infrastructure
- Housing infrastructure
- Care for seniors/disabled

- Upgrading commercial buildings
- Improving American manufacturing

Specific spending details are scarce at this time, but assuming the bill was to pass in its current form, we've identified several of the portfolio's holding that would stand to directly benefit. They include:

- **REV Group** (model weight: 2%): Leading designer, manufacturer and distributor of specialty vehicles, including school and municipal buses, ambulances, fire engines, mobility vans and street sweepers. REV Group's product suite is well-positioned to benefit from higher demand if the infrastructure bill helps shore up the finances of municipalities and townships.
- **Belden** (3.5%): Premium signal transmission company with a recently simplified portfolio of products focused on higher value-added and growth. Belden's Smart Building segment, which accounts for about a quarter of total sales, manufactures wires, connectors and components for commercial buildings, and stands to directly benefit from the bill's provision that aims to retrofit approximately 4 million buildings across the country. Belden's Broadband & 5G segment accounts for another 25% of sales, with the remaining ~50% related to industrial automation and cybersecurity – all focus points of the Biden infrastructure bill.
- **MasTec** (1.5%): Contractor that executes small to medium-sized construction projects on behalf of its customers. MasTec's Power Generation & Industrial segment, which accounts for 14% of revenue, performs construction work for solar and wind farms; funding for clean energy initiatives will almost definitely be included in a potential Biden infrastructure package, and as more solar and wind farms are installed and eventually age, there will an opportunity for aftermarket service and maintenance work for MasTec, which is typically more lucrative than initial installation revenue. To the extent that the package also includes

funding for an accelerated 5G buildout, MasTec would generate incremental sales (5G requires a denser cell tower network, and MasTec is involved in the construction and optimization of cell towers and associated backhaul cable networks) while continuing to bring in service revenue from the existing network.

- **Terex Corp.** (3%): Manufacturer of aerial work platforms and materials processing machinery. Terex is close to a pure play on a comprehensive national infrastructure spending plan, as its products (aerials, mobile/tower cranes, mobile crushing, mixer trucks, scrap handling, etc.) are generally required for a most types of construction projects.
- **Dana Inc.** (3%): Supplier of drivetrains for light vehicles (LV), off-highway and commercial vehicles. The key for Dana with regards to the infrastructure bill is the vehicle electrification push. Dana, as an incumbent in the space, should be positioned well if and when its LVs electrify since the underlying vehicle will be more complicated than a passenger car, relying more on the axle as a performance differentiator. Dana has also been receiving contract wins from automotive manufacturers for its segments that have electrified, or is in the process of doing so, including medium duty trucks and some off-highway vehicles. The company has been investing in its electrification portfolio in recent years, which has proved timely, and should enable it to keep winning EV business going forward.
- **Steelcase** (3%): The office furniture company also has a sizable school furniture portfolio with a characteristically large product breadth that could certainly gain from a major school infrastructure overhaul.

2.) What is the confidence level (either from you or if you have gotten an indication from management) of your portfolio of companies that they would be able to pass on any input

price increases they may face in the near future?

Many of the companies in the portfolio are leaders in their respective niche industries, and as such, maintain significant market share which tends to manifest in pricing power. The lingering effects of the pandemic-induced global economic shutdowns have generally resulted in capacity shortages, which effectively boosted companies' pricing power. While it's clear that freight, raw materials and input costs overall have risen in recent months, we've identified this as more of a systematic issue instead of company-specific. When essentially every company in a given industry is experiencing the same type of supply and production issues, it's much easier to pass through price increases to customers – and this is exactly the dynamic we see playing out right now. That said, many companies reduced headcounts during the downturn as part of an effort to right-size cost structures when demand fell off. As a result, businesses are now operating much leaner then they normally would, relying heavily on temporary labor in some cases. Therefore, we wouldn't be surprised to see companies incur additional costs from ramping up production to service demand spikes as the economy continues to recover. We would expect, however, for these cost increases to be more transitory, but associated price increase to be more structural in nature. To summarize, at a high level, we do anticipate a moderate rate of inflation to have a net positive effect on the portfolio