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American Water Intelligence

Market-Leading Analysis of the American Water Industry

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Heckmann's power move

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TRACKER UPDATES

Detroit Biosolids Facility Dryer, MI: Bids are due Oct. 30 for this $157 million DBOM contract.

Dublin Road WTP Expansion Phase I, OH: Bids are due Oct. 18 for this $40 million project.

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American Water Awards shortlist

AWI announces the nominees for the first-ever American Water Awards, which will be decided at the American Water Summit in November. PG23

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THE WATER NEXUS

Alexander Miles, a managing partner at Kingfisher Capital, explores new, innovative and contrarian ways of evaluating water as an investment.

Drought of ideas in D.C. may flood market

With key U.S. elections looming and a faltering European economy, it is appropriate to step back from a discrete discussion of the water industry to provide some insights on how capital allocation decisions and market behavior may be impacted over the coming months. The water industry is deeply embedded in our economy while touching so many vital areas such as food, energy, health care and technology. Water has increasingly become the centrifugal driver of decision-making around where to build a plant, how to exploit a non-conventional energy asset, whether to invest in technology for crop management and irrigation and how to assess waste management and smart technologies for efficient resource utilization, among others. Water has also emerged as a key risk factor for corporations, governments and investors when contemplating both strategic initiatives and assessing risk and stress models. We all recognize the water imperative, but how will we fund demand in a world that seems increasingly capital constrained?

When looking across the global landscape, it is hard not to recognize that we are facing a bit of a perfect storm. During the roughly 50-year period following the end of the Second World War, the western world participated in the greatest economic boom in history, fueled by breakthroughs in healthcare, energy, transportation and, most importantly, technology. Our increasing productive capacity sponsored a radical steepening in the slope of human progress. Yet it is important to note the key underpinning of this successful era: the consistent availability of capital in an extended period of ever-expanding credit.

The Great De-leveraging

Beginning around 1999, the United States, and more broadly Western Europe, entered a more challenging phase as we bumped up against the outer limits of credit expansion. The Great Era of De-leveraging began with the collapse of the technology-focused NASDAQ stock market in late 2000. The credit bubble was reflated during the Greenspan era when extraordinarily accommodative Federal Reserve policies and widespread congressional support of individual home ownership inspired massive risk-taking and creative financing tools. A majority of financial institutions and individuals became over leveraged, leading to a second collapse, this time of the housing and banking sectors in 2008.

During the fall of 2008, both the U.S. Treasury Department and the Federal Reserve Bank collaborated on yet another series of aggressive policies to stabilize financial markets and recapitalize banks. This policy response has, over the past three years, helped to reflate the stock market (U.S. markets have doubled from the March 2009 lows) and, as recent data suggests, restored price stability to the housing market. The eurozone, with its 17 member nations and decentralized authority, did not undertake such swift and radical action, and is far behind in the recovery, only recently seeking to unify with the promise of bold action.

Today, the central banks of the world's largest economies, led by Federal Reserve Chairman Ben Bernanke, have determined that in the battle between deflation and inflation, inflation is the least painful and preferred outcome. A revival in the housing market would have the greatest positive impact in restoring wealth to the shrinking middle class. So today, 12 years into the Great De-leveraging, corporate balance sheets are strong and individual balance sheets are improving. But where did all the debt go? It has been absorbed onto government balance sheets. As such, the remaining levers Bernanke can manipulate are now limited and must be accompanied with bold action from fiscal authorities.

Governments can reduce deficits by raising revenues through higher taxes and cutting expenditures, both of which have the potential to curb growth and increase unemployment. Austerity is unpopular and can inhibit growth. Higher tax rates lead to expatriation of assets. If tax policy becomes too onerous, take for example in Greece and Spain, taxpayers will simply refuse to pay.

When large economies reach limits in their ability to expand credit, they limit investment in public projects, seek to redistribute wealth to support entitlement programs and become less competitive. It is imperative that our government acts proactively to reduce deficits, as the risks are profound. In the meantime, monetary policy will continue to support risk assets and push large investors out of safe-haven assets, as long as a pathway to fiscal responsibility is deemed credible. Today large allocators of capital remain abnormally risk averse. With monetary stimulus serving as a bridge, positive outcomes in dealing with our fiscal imbalances will serve to accelerate the tilt from risk aversion to risk acceptance among large allocators of capital. Such momentum could, in turn, fuel a surge in business confidence, boost hiring and place us back on the path to prosperity. But elected officials must act quickly to divine and enact principled compromise.

With government funds in purgatory, private capital will increasingly take up the mantle in supporting water, energy and transportation infrastructure. Water will remain the critical asset of our time. Water demand is not cyclical, it is persistent. It is not driven by speculation, but by necessity.

Alexander Miles is managing partner and chief investment officer at Kingfisher Capital. He serves as manager for both traditional and alternative investment strategies with a focus on water, sustainability and the water-energy-agriculture nexus.