

# HOW TO INVEST IN THE REST

The best way to tap into the rise of the emerging markets may well be through select U.S.-based corporations with global reach.

BY IAN PRIOR, *U.S. Trust*

THE WORLD DIDN'T STOP turning in 2008, but in a sense it did turn upside down: The United States entered the Great Recession, followed in short order by others in the Western economic bloc, including Great Britain, Japan and virtually all of Europe. After a century as arguably the greatest industrial and consumer force in history,

the West, with the U.S. consumer at the forefront, saw its top-dog standing slip.

At about the same time, a slew of eternal underdog developing nations, sometimes dubbed The Rest, including China and India, with several decades of steady urbanization and industrialization behind them, found themselves at long last standing

almost toe-to-toe with the West.

It was an upending on a massive scale, what some have called a great global shift — and the world may never be the same again. What's more, says Joseph P. Quinlan, chief market strategist at U.S. Trust, "this rebalancing of the global economy is one of the most important trends of our time."

**MIDDLE CLASS RULE**

What’s behind this remarkable makeover? “At its core are the burgeoning middle classes of China, Brazil, India and Turkey, and consumers elsewhere in the developing nations,” Quinlan says. “Whereas past generations of workers across those countries spent Saturdays on the factory floor, today’s workers are likely to be found in air-conditioned malls on the weekend, spending their income on goods and services the average American takes for granted.”

Figure 1 shows the growing power of the emerging markets as a percentage of the world’s Gross Domestic Product, or GDP. Note the significant rise since 2000. The emerging markets already account for a greater share of world GDP than the United States and its Western cohorts.

Figure 2, perhaps just as telling, depicts the dramatic rise of the global middle class. According to the Brookings Institution, this middle income group totaled roughly 1.8 billion

consumers worldwide in 2009, with more than half (54%) of these consumers domiciled in North America and Europe, or the developed nations. By 2020, however, the same group is expected to jump to 3.2 billion consumers and then by 2030 to 4.9 billion. “Almost all of this increase is expected to come from the emerging markets, whose share of the global middle class is expected to rise from 46% in 2009 to 62% in 2020 and then to roughly 80% in 2030,” Quinlan says.

**INVESTING THROUGH THE SIDE DOOR**

As you might expect, whenever economies are growing, investment opportunities arise. But for many investors (including some U.S. Trust clients), the global rebalancing presents a dilemma. They would like to benefit from this rise in consumerism in the emerging markets but are reluctant to invest directly in companies in those countries.

Their caution is understandable. Many developing nations,

**THE DEVELOPING NATIONS’ SHARE OF WORLD GDP IS ALREADY ABOVE 50%.**

after all, still have work to do before they can shed a long-standing reputation for corporate accounting irregularities, political unrest, currency instability and other factors that typically give prudent investors cause for concern. Fortunately for the reticent investor, many companies that seem likely to benefit from the rise of the developing world are not actually based in the developing world. Rather, they are predominantly U.S.-based and have names familiar to most of us.

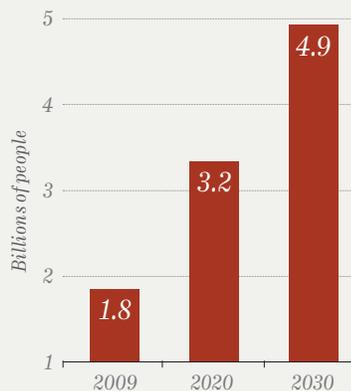
Says Quinlan: “Workers in the developing nations are also consumers. Yes, they save more than the average American, but factory and office workers — whether in Beijing, Bangalore or Bratislava — are not averse to spending some of their income on themselves or their families. And the more these new consumers spend, the more demands they place on the world’s energy and food infrastructure, with the rise in energy and food prices over the past decade directly tied to soaring consumption levels and more Western-

**FIGURE 1: The Developing Nations’ Share of World GDP Is Already Above 50%**

(Based on Purchasing-Power-Parity [PPP] Share of World Total)



**FIGURE 2: The Global Rise of the Middle Class**



Source Figure 1: IMF April 2012 WEO Database. Data for 2012–2017 is estimated.  
 Source Figure 2: Global Trends 2030 Report, Institute for Security Studies. Data as of May 7, 2012. Data for 2020–2030 is estimated.

like lifestyles in the developing nations. And this same dynamic has been hugely beneficial to many U.S.-based multinational companies, ranging from auto-makers to retailers to consumer electronics producers.”

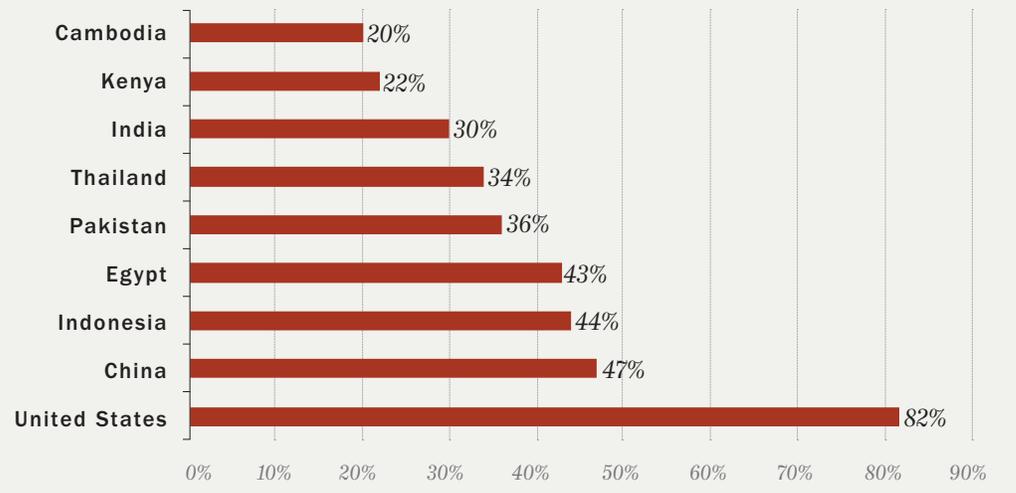
In short, investors wary of lesser-known companies in emerging markets can instead turn to brand-name U.S.-based corporations with global reach. More on those companies later.

### CITY-BOUND, UPWARDLY MOBILE

Most if not all of the countries that constitute The Rest — those with economies that are growing impressively even as the West’s appear to be producing anemic growth at best — have undergone varying degrees of urbanization. “Rural inhabitants moving to the big city is a key factor in promoting consumption — and is probably the main factor in a region’s economic rise,” says Quinlan. “Rural life is difficult, with many people living without potable water and electricity, and dependent on kerosene or even cow dung for light and heat. A small plot of land provides a minimal amount of food for a typical family. Life in the rural areas, in other words, is rather simple and devoid of consumption.”

But things change when people move from the farm to the big city, he says. “Take a woman who relocates from a poor rural village to a major industrial center to work in a manufacturing plant. She will use more water and eat more food, and as her income rises, she will have discretionary income to buy goods for herself — clothing, consumer electronics and the like. She is becoming a global consumer. And there were nearly 250 million more

FIGURE 3: Urban Populations, 2010



Source: United Nations. Data for 2010.

people just like her in China alone over the past decade.”

For the first time in history, in fact, just as many people live in cities as in the country — the global urbanization rate reached 50% in 2010 and is expected to jump to two out of three people in the next few decades. “That’s a remarkable trend often overlooked by American investors, and perhaps for good reason: Roughly 82% of the U.S. population lives in a city,” Quinlan says. “Urbanization, in other words, is nothing new or unusual to most of us. But urbanization is one of the most significant global macro trends of our times.” Figure 3 gives some sense of urbanization around the world.

Urbanization not only increases the demand for food, water, electricity and other forms of energy; it also places new demands on governments for housing, schools, hospitals and other basic services. “That means more capital goods will be required to help build out the

### URBANIZATION IS ONE OF THE MOST SIGNIFICANT GLOBAL MACRO TRENDS OF OUR TIMES.

infrastructure — think heavy equipment, pumps, valves, and other infrastructure-related goods and services,” Quinlan adds. “The demand for telecommunications equipment, consumer electronics and services will also climb as more and more people come online and get connected.”

Emblematic of rising consumption levels in developing nations are rising imports, with those countries’ share of world imports climbing from around 30% of the total in 1999 to over 45% in 2011. In the not-too-distant future, the share will almost certainly top 50%. This rebalancing is evident in Figure 4.

### COUNTRY BREAKDOWN

While they may share similarities, no one developing nation has undergone exactly the same changes as another. As a result, investment opportunities will differ by country or by region. Quinlan’s views on which industries seem

likely to prosper from the rise of The Rest follow each country's description.

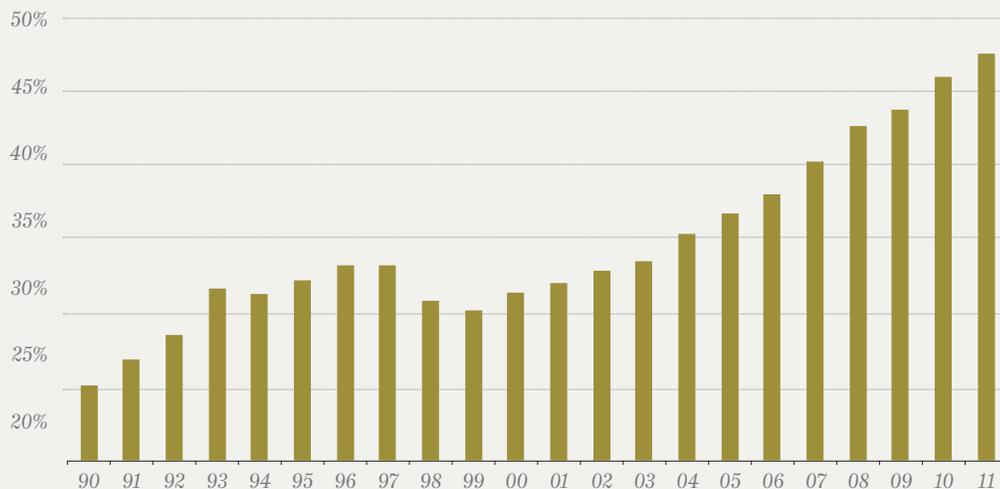
China is far and away the largest component in the rise of The Rest. And even though Beijing recently announced its plan to strategically lower the nation's three-decade-long annual growth rate of 10%, the new target, 7.5%, is still far above the current U.S. growth rate of about 2.5%. One way the Middle Kingdom plans to accomplish this strategic slowdown is by shifting its focus from exports to imports, or from its industries to its consumers. Says Quinlan:

"This pivot toward more consumption-led growth — a long-term prospect, for sure — should prove to be hugely beneficial to China. We also think it will be a significant source of sales for American companies for the foreseeable future." *Look for opportunities in luxury goods, automobiles, food and beverages, infrastructure development, technology, and hotels and tourism.*

**India.** Infrastructure development in India has been a key theme for the past 10 years and will likely remain so for the next couple of decades, as the "Tiger" still has much work to do. "Nearly one-fourth of the country, or over 300 million Indians, has no access to safe drinking water; over 300 million have no access to electricity, and half the population does not have sanitation facilities," says Quinlan. What's more, "over the past 50 years or so, India's total vehicle traffic rose more than a hundred-fold, whereas the road network increased just eightfold. Four major highways constitute 2% of the entire nation's road

**FIGURE 4: The Baton of Consumption Has Shifted to The Rest**

(Developing Nations' Percentage of World Total Imports)



Source: International Monetary Fund Direction of Trade Statistics. Data through 2011.

network but carry 40% of the combined traffic load. At the same time, there are 830 million mobile phone subscribers." *Look for opportunities in commodities, building materials, construction machinery, transportation equipment, financial institutions, communication equipment, technology services and related subsectors.*

**Latin America.** Real GDP growth in Latin America slowed in 2011, but the region still managed to expand by 4.5%, nearly triple the rate of growth of the advanced economies as a bloc. "The region is not without problems, but this isn't your father's Latin America," Quinlan notes. "Political stability, prudent macroeconomic policies, moderating inflation — all of these metrics have become staples in the region. Another key dynamic, reflecting rising per capita incomes and a budding middle class, is that personal consumption expenditures in

## EMERGING MARKETS ARE DRIVING GLOBAL GROWTH, CREATING NEW INVESTMENT OPPORTUNITIES.

Latin America totaled roughly \$2.6 trillion in 2009, double the level of consumer spending in the Middle East and Africa and nearly one-third larger than spending in central Europe."

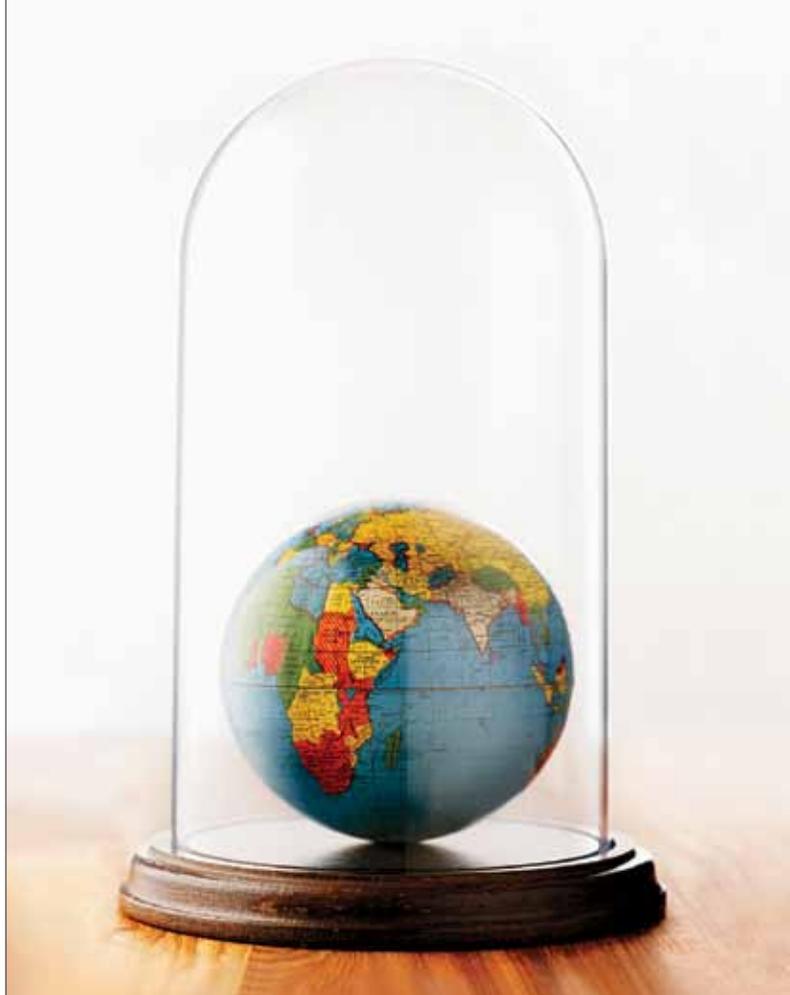
While poverty remains acute in some parts of the Western hemisphere, says Quinlan, "poverty rates in Latin America declined by over 10 percentage points between 2002 and 2008, pulling more than 40 million people out of poverty, according to the World Bank, and income inequality has been greatly reduced over the past decade. In Brazil, now a regional economic powerhouse, the nation's per capita GDP was nearly \$12,788 in 2011, more than three times the \$3,761 level of 2000. Against this backdrop, it is no wonder that Brazil has emerged as a key consumer of many U.S. goods and services, and is now a global leader in consumption. For instance,

the Latin giant is now the third-largest beauty market in the world after the United States and Japan.” *Look for opportunities in transportation, financials, energy, materials and food products.*

**Africa.** “The continent has long been challenged by a wide variety of geographical, economic and political obstacles,” Quinlan says. “But sub-Saharan Africa alone has become the second-fastest-growing region in the developing world, behind developing Asia. Demand for food there is expected to reach \$100 billion by 2015, double the levels in 2000. The dramatic economic growth and spread of democracy have attracted the attention — and the capital — of multinationals and private equity investors.” The African Development Bank estimates that the continent now has around 300 million people with incomes in excess of their basic needs, a rise of more than 60% from a decade ago. *Look for opportunities in food products, technology, telecommunications, energy, agriculture and tourism.*

**Central and Eastern Europe.** “This area has been hurt by the Eurozone debt crisis, although the underlying dynamics of the region remain quite promising,” Quinlan says. “Indeed, markets like Poland, the Czech Republic, Slovakia and others in the region represent new and untapped markets for corporate America. Expansion of the European Union (EU) has given U.S. firms access to new consumers. Polish workers and others are also consumers, and consumerism — as measured by personal consumption expenditures — has soared over the

past decade in the East, owing to greater employment, rising incomes and, most of all, pent-up demand for Western goods after decades of denial.” All told, personal consumption in Eastern Europe doubled between 1990 and 2005 and then nearly doubled again by 2010, when expenditures totaled an impressive \$2.3 trillion. “That is not bad for a part of the world held under lock and key and cut off from the global markets during the Cold War,” Quinlan adds. “In the end, consumption is serious business in Central and Eastern Europe, accounting for nearly 60% of GDP in 2010.” *Look for opportunities in consumer products, technology and communications.*



**FIGURE 5:**  
**Top 20 Most Valuable U.S.-Based Global Brands**

Top 20 U.S. brands are extracted from BrandZ Top 100 Brands, a listing that includes U.S. and non-U.S. companies. Excludes financial companies. Data as of May 23, 2012.

Ranking in Top 100 List	Brand	Brand Value 2012 (\$mil)	Category
1	Apple	\$182,951	Technology
2	IBM	\$115,985	Technology
3	Google	\$107,857	Technology
4	McDonald's	\$95,188	Fast Food
5	Microsoft	\$76,651	Technology
6	Coca-Cola	\$74,286	Soft Drinks
7	Marlboro	\$73,612	Tobacco
8	AT&T	\$68,870	Telecom
9	Verizon	\$49,151	Telecom
11	GE	\$45,810	Conglomerate
16	UPS	\$37,129	Logistics
17	Walmart	\$34,436	Retail
18	Amazon	\$34,077	Retail
19	Facebook	\$33,233	Technology
26	HP	\$22,898	Technology
27	Oracle	\$22,529	Technology
33	Gillette	\$19,055	Personal Care
34	ExxonMobil	\$18,315	Oil and Gas
35	Pampers	\$18,299	Baby Care
42	Starbucks	\$17,072	Fast Food

## SUMMARY

“This new era of globalization is at the heart of our investment thinking — that, yes, the emerging markets represent both risks and rewards for the old economic order. But their inclusion and leadership in driving global growth — notably consumption — is hugely bullish for world financial markets,” Quinlan says. “Notable here are Western multinationals with significant exposure to the developing nations and to those emerging markets where consumption is going mainstream. An exciting new phase of globalization has begun, and the rewards for investors outweigh the risks, in our view.” Figure 5 offers a sampling of these types of companies.

If you’d like to learn more about investing in The Rest, please contact your U.S. Trust advisor. **CA**