

PIONEERINGEMERGINGMARKETS

**Presentation to Society of Industrial and Office Realtors
“The Emerging Markets Century”**
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Crises – then ...

1994 Mexican Financial crisis

1998 Asian Financial Crisis

Crises – then... and now

1994 Mexican Financial crisis

1998 Asian Financial Crisis

2008 American Financial Crisis

The “American” Financial Crisis is perhaps a symptom of bigger changes

- This time, the crisis comes from *outside* emerging markets
- The U.S. has over-consumed, over-borrowed and under-invested
- Others adopted the “Washington Consensus” but U.S. did not follow its prescriptions

Part of a much bigger long term shift which will re-define opportunities and risks



3

The 20th century

“We”

- Wealth
- Surpluses
- Technology
- Innovation
- Infrastructure

Emerging Markets

- Debt
- Deficits
- Cheap labor
- Imitation
- Poor/few roads, ports, power plants

The new reality is rapidly changing



4

Already the world has changed

- Mobile phones are universal
- Emerging markets own 75% of all foreign exchange reserves
- China’s infrastructure and new buildings are impressive
- Building boom from Middle East to BRICs

Emerging markets are catching up fast



5

Two shifts that will redefine challenges and opportunities

1. "New" economies

- *the biggest shift in the global economy (and power) since the Industrial Revolution*

2. Emerging multinationals

- *no longer second-rate producers of "cheap" goods but increasingly "world class"*

- *will they eat your lunch or become your best customers?*



6

...and a global challenge that affects all of us

1. "New" economies

2. Emerging multinationals

3. Risk of global environmental gridlock

- *We either become green or we are dead*



7

Each challenge creates its own opportunity

- The world is not a zero-sum game
- Denial and protectionism will get us nowhere
- A creative, innovative response has succeeded before

Business can no longer be "as usual"



8

Only at the start of a 50-year real estate boom in emerging markets

- Urbanization
- Huge pent-up housing demand
- Substandard construction
- Spread of mortgage finance
- Money to burn (especially in Middle East)



9

Only at the start of a 50-year real estate boom in emerging markets

- Huge pent-up housing demand
- Substandard construction
- Spread of mortgage finance
- Money to burn (especially in Middle East)
- **New** support from infrastructure
- **New** building codes
- New desire for eye-catching public buildings
- **New** need for “green” architecture



10

Quite an evolution in 20 years

20 years ago

- Peripheral
- Poor
- Behind
- Protected
- Undiscovered

Now

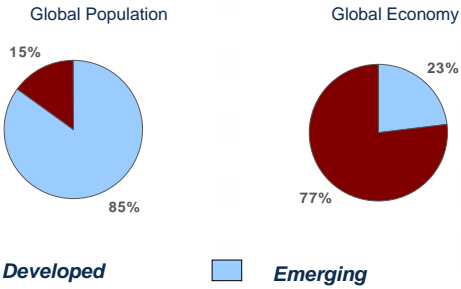
- Players
- Soon middle-class
- Catching up
- Competitive
- Fashionable

The World is not flat, it is tilting – away from “us”



11

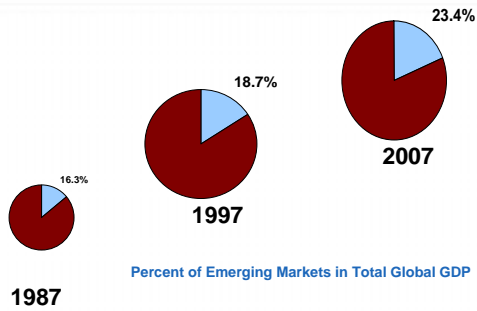
Emerging markets will catch up



Source: World Bank Atlas; JP Morgan; S&P Global EM Fact Book



Emerging markets are now relevant but not yet dominant



Source: J.P. Morgan



Emerging Markets: not just bigger but healthier

	1990	2000	2005
GDP	\$4 trillion	\$6 trillion	\$9 trillion
Inflation (%)	468%	6.7%	4.7%
Fx Reserves	\$213 bill	\$777 bill	\$2.2 trillion
Foreign Debt	\$1.0 trillion	\$2.0 trillion	\$2.2 trillion
Current Account	-\$14 bill	\$47 bill	\$217 bill
Exports	\$694 bill	\$1.8 trillion	\$3.4 trillion
as % of World Budget Deficit	21% \$249 bill	29% \$137 bill	34% -\$29 bill

Source: JP Morgan



Shifting center of gravity

- Without legacy burdens, emerging multinationals sometimes “leapfrog”
- Fast growing consumer demand in “home” markets
- The United States is less and less the “model”
- China on its way to become the world’s “anchor economy”

Shift of opportunities AND risks



15

What's new?

Emerging markets 2.0 are fundamentally different from Emerging Markets 1.0

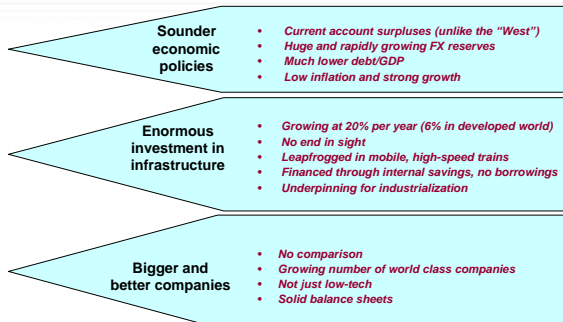
The developed world must adjust from a less dominant position

The competitive edge is shifting



16

Emerging markets 2.0 are more solid than 1.0

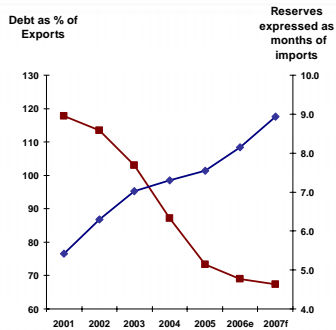


Source: J.P.Morgan, EMM estimates



17

Emerging markets external debt vs. reserves



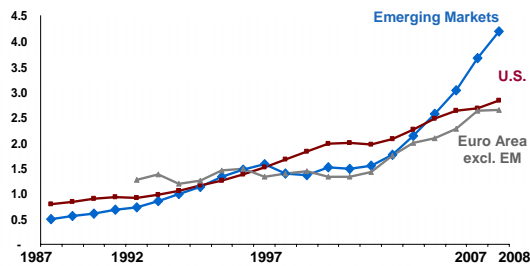
Source: Institute of International Finance



18

Outspending US and Europe on infrastructure in a major boom

Gross Fixed Capital Investment (US\$ trillion)



Source: J.P. Morgan



19

How is the competitive landscape changing?

- ✓ Traditional multinationals are *already* dependent for much of their growth on emerging markets (GE from 15% to 30% by 2010)
- ✓ More beer, TVs, cell phones, refrigerators and – within a decade – cars are sold in emerging than developed markets
- ✓ More people watch Bollywood than Hollywood movies
- ✓ “Asian Tigers” are becoming de-facto satellites of China
- ✓ Takeovers now by emerging multinationals

The “home market” advantage is tilting to big emerging markets



20

How emerging will surpass developed markets

Projected GDP (US \$ trillion)				
	BRICS	G7	Emerging	Developed
2005	4.2	27.3	8.9	32.4
2030	28.2	43.0	46.8	51.6
2050	90.0	64.2	138.0	77.0

Emerging markets will surpass developed countries in about 25-30 years and will be nearly twice their size by mid-century

Source: Goldman Sachs for BRICS/G7, EMM calculations for Emerging/Developed assuming G7/Developed countries will remain stable, BRICS/Emerging will increase, China will slow down and emerging market currencies will strengthen



21

A vastly changed world in 25 years

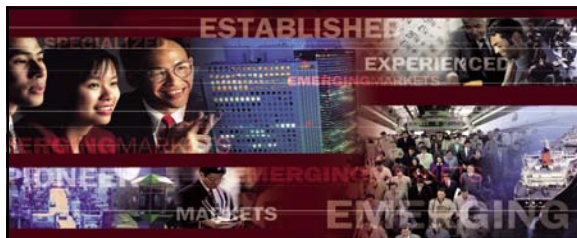
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In 25 Years

Players	Dominant
Few middle-class	Many middle-class
Catching up	No longer behind
Competitive	Even more edge
Fashionable	Fully mainstream



22

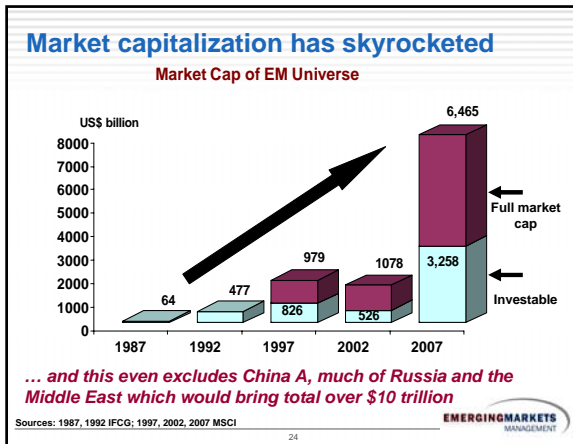


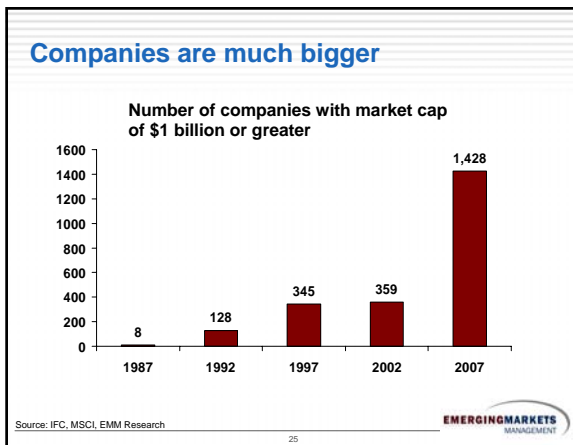
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“World Class” emerging multinationals
*Foot soldiers in the rise of emerging economic powers
 From cheap, second rate to world class in quality*



23





A look at the Fortune Global 500

- **69** of global Fortune 500 (in 2007) from emerging markets
- In **ten** different industries
- But nearly **2/3** (many in energy) are still government controlled
- Potential for many existing "world size" companies to become "world class"

Many top emerging corporations are now "world-size" – but only a few are truly "world class"


Source: Fortune 500; EMM

EMERGINGMARKETS MANAGEMENT

26

Myth #1:
The “West” has a birth right on dominance

- What if it is no longer ahead in technology?
- What if “poor” countries begin to catch up?
- What if crises originate in the West?




30

Myth #1:
The “West” has a birth right on dominance

- What if it is no longer ahead in technology?
- What if “poor” countries begin to catch up?
- What if crises originate in the West?

- Reversal of brain drain, capital flows, and deficits
- Acquisitions are now a two-way street
- Dependent increasingly for energy, manufacturing
 ... and soon also money, technology, and fashion


Soon no longer the center of the global economic universe



31

Myth #2: It is all about cheap labor

- Only four of the 25 companies profiled in my book rely on “cheap labor”, 16 are hi-tech or capital intensive
- Technology is well represented
- Not just cheaper, but smarter and better
- The key success factors are more “man-made” than based on cheap labor or resources



32

Myth #3 Only imitators, not innovators

- ✓ Invented new industry model: **Aracruz, TSMC**
- ✓ Coal-to liquid: **Sasol**
- ✓ Using logistics as a competitive edge: **Tenaris, Cemex**
- ✓ Turn outsourcing upside down: **Embraer**
- ✓ Deep-sea drilling: **Petrobras**
- ✓ Biofuels and flex-fuel cars: **Brazil**



33

Five keys to world class success

1. Intuitive, unconventional thinking
("You are crazy")
2. Creative and speedy adaptation
(strategy is often after-the-fact)
3. A global mindset
4. Strong but disciplined ambition
5. Obsession with execution and quality

Lessons for world-class "wannabees" everywhere



34

The Yin and Yang of the Emerging Markets Century



"We have, at most, 10 years to alter the trajectory of global greenhouse emissions."
--NASA scientist Jim Hansen, July 2006

"If not reversed, environmental degradation threatens to become a major impediment to economic development in China and India"
- *Der Spiegel*



35

Time is running out to ignore huge issues

CO2 emissions



Energy supply



Water shortages



Waste management



Without action and innovation, enormous progress could be derailed

Source: web photos, photo by Michael Keller etc.



36

Emerging markets can no longer get a free ride

- China will soon overtake the United States as the biggest polluter and India will overtake Europe
- Outsourcing of industry also means outsourcing of pollution
- Developed countries still remain the biggest polluters but most of the growth is in Emerging Markets – *Kyoto is not enough*
- Unfortunately, the higher growth and greater prosperity in emerging markets also means even higher emissions

Emerging markets are now an important part of the problem



37

A whole symphony of solutions will be required

Energy conservation, cleaner coal, more gas and nuclear, but also using *today's* power of the sun will all play an integral part

- Thermal
- Biofuels
- Solar
- Wind
- Tidal
- Small hydro
- Clean Coal
- Gas
- Nuclear



38

Emerging Markets are catching up

- China and India get 2-3% of electricity from nuclear energy, Korea 40%, Taiwan 21%, the United States 20% and France 80%
but most new reactors are now built or planned in developing Asia
- Japanese (48%) and German companies still lead in solar cell production
but China and Taiwan are now as large as BP and larger than Shell Solar
- India still produces less ethanol than the United States
but is #4 globally and its biodiesel costs 1/3 that in the U.S. or Europe

*Source: World Nuclear Association



39

Energy supply will become an increasing problem

- 1 billion people use 85% of the world's energy
- 3 billion people use the other 15%
- 2 billion people are "energy wannabees"
- More power stations, more factories, more cars and more planes will use more energy and emit more CO₂
 - *Already own more TVs, refrigerators and mobile phones*
 - *Car ownership in China and India is rising fast*

The Emerging Markets Century is a double-edged sword

*Source: Simmons & Company International, Deloitte Conference



40

Water: dirty and not enough for a thirsty world

- Indus, Nile and Yellow river no longer bring water to the sea parts of the year
 - *"The survival of the Chinese nation is threatened by its shortage of water"*
- *Wen Jiabao, Prime Minister*
 - *136 Chinese cities face severe water shortages*
 - *49% of China's arable land is irrigated (33% India, 6% US, 1% Brazil)*
 - *Large Chinese steel mills use 60% more water than in US or Japan*
 - *Beijing and Shanghai have fewer per capita fresh water resources than Israel, Jordan or Yemen*
- Use of nitrogen fertilizer has increased 8x since 1960
- 10% of global food production depends on "over" pumping of groundwater (25% in India)
- Agriculture uses 90% of all water (but half is wasted)
- Drip irrigation is used on only 1% of all irrigated land but reduces water used by 30-70% and 20-90% higher yield

*Source: Worldwatch Report, CLSA



41

Waste and water treatment

- In India, only 10% of sewage is treated
- Less than half of China's 660 big cities had water treatment plants in 2002, treating only 22% of urban waste water
- Interestingly, European companies have been more active in China and India thus far than emerging multinationals

Enormous growth expected in this area

*Source: International Atomic Energy Agency



42



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The need for a creative response



43

What to expect?

- A global race for a better **infrastructure**
- Second-rate competitors of a few years ago may become challengers, industry consolidators, merger candidates or even major clients
- “Green” will become more than a slogan – it will reshape the design of homes, offices, cities and transportation
- Modern retailing will take off – but not just “big boxes”
- Iphone** look-alikes will take the world by storm
- Health care** will become a booming industry in emerging markets
- More mortgages, more **houses**

All of this will affect YOU in vital ways



44

A Creative Response at the national level

Not a zero-sum game
The United States has overcome challenges before
Protection failed – creative response needed
The challenge is less to our future standard of living
It is our competitive edge that is at stake

**National Competitiveness campaign
Ambitious, rousing goals**

(a new “man on the moon” campaign)



45

National Competitiveness Campaign

Deal with legacy issues (*pensions, health care*)
Support basic research + Bell Lab for 21st cent.
Get rid of the current account deficit
Emphasize creativity and fusion of design and technology in education
Give infrastructure a much-needed face-lift
Bring back pride in public buildings and cutting-edge city design

We should hold our political candidates accountable for innovation rather than protectionism



46

Friend or foe – the corporate response

Focus on niches others ignore
Stay ahead in R&D
Forge alliances, including joint design
Have an emerging markets strategy, otherwise you miss out on most of the growth
Develop a broad range of personal relationships with emerging multinationals
Beat your competitors in how fast you adapt

Emerging multinationals will eat your lunch unless you make theirs – but better



47

And what does this all mean for you?

- Your clients will increasingly be in emerging markets, including BRICs and Middle East
- Your competition will be global, including from emerging multinationals
- Outsourcing and joint design are no longer an option but a necessity
- China is both manufacturing hub and key growth market
- Your staff, R&D engineers and management must be increasingly diverse



48

Seek a new competitive edge

- Innovate in architecture, use of new materials, green technology, and city design
- Focus on growing national pride
- Be early in recognizing demand for integrated “work-live-and play” environments
- Study the requirements of the new middle class in emerging markets

Often, emerging markets will not follow but leapfrog



49

What should today’s multinationals learn?

- Nurture unconventional thinking
- Focus on listening rather than “preaching”
- Promote a global mindset
- “Embed” staff abroad in emerging multinationals
- Develop a North-South strategy
- Creative and speedy adaptability is key



50

Practical tips

- Take emerging markets seriously but don't rush
- Don't expect to be "special"
- Even more so than usual, don't believe everything you hear and see
- Emerging markets are more than just the BRICs
- Customers in emerging markets often want the best rather than the cheapest
- Don't venture into areas that are new without trusted (hard to find) local guidance or language knowledge
- Attend local conferences
- The best opportunities are sometimes not in "high growth" areas but those that are unpopular (e.g. Zimbabwe now)

Go but tread cautiously



51

Outlook

A few words about the American financial crisis and its impact



Good news...

Long term, emerging markets present a gigantic opportunity and are the right place to be

.... as they continue to benefit from a dramatic shift in the global economy

We are entering the Emerging Markets Century



53

Good news... and bad news

Long term, emerging markets will benefit from a huge shift in the global economy

but

Short-term, we will face more volatility and correction in many stock markets and even real estate markets

as over-enthusiastic investors mostly ignored some big storm clouds in the global economy



54

Contrasts

2007

- Global Liquidity
- Mortgages booming
- Strong growth
- Shortages
- Focus on growth
- Upward market trend
- Mesmerized by opportunities

2008

- Growing credit squeeze
- Spread of global caution
- Slowing
- Growing inventories
- Focus on inflation
- High volatility
- Concerned about risks



55

Emerging market are no longer at lower valuations than other equity markets

Relative valuations and growth

MSCI*	P/E 2007e	P/E 2008e	EPS Growth % 2008e	P/BV (trail.)	Div. Yield %
USA	14.0	12.3	13%	2.9	2.4
AC World Index ex USA	11.5	10.7	10%	2.4	3.4
Emerging Markets	15.2	13.1	16%	2.5	2.2
EMM**					
EMM Global Active	13.1	12.3	25%	2.3 (2007e)	2.5 (2008e)

As quality has improved and growth remains faster, the risk premium has declined as it should and is now closer again to fair value (but earnings may need to be readjusted)

Source: * Morgan Stanley as of February 29, 2008
** EMM data as of February 29, 2008



We have viewed China's stock market as a "bubble" for some time

- The investing experience of the Chinese "public" is new
- The recent market rise had been overly rapid
- Stock market gains overstate recent earnings growth
- Valuations became unattractive on a global basis
- The economy is growing above its "cruising speed" and needs reining in
- Export growth as a driver will slow as China's growth is more dependent on US than often thought



57

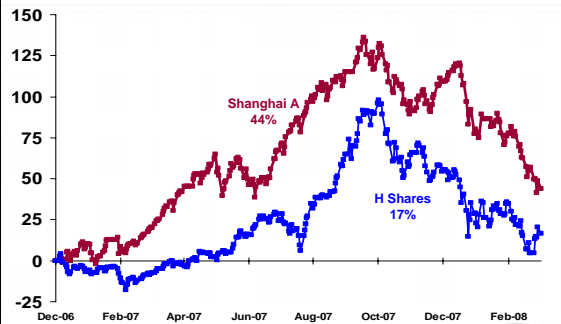
Sudden reversal of a huge recent boom



Source: Bloomberg; Sept. 2002 – March 10 (Price Return US\$)



The H share market erased most of last year's gains



Source: Bloomberg Dec. 31, 2006 – March 31 (Price Return US\$)

59



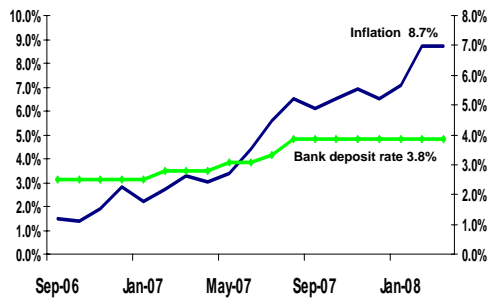
Exports to United States as % of GDP

	1980	2006		US contrib to growth
Euro area	1%	2%		0.1%
G-10	2	5		
Mexico	5	22	biggest	0.7%
China	1	8	huge rise	1.0%
Korea	7	5	lower	
India	1	3	modest	

Source: OECD, Lehman Brothers "Global decoupling"



Domestically, inflation remains a problem



... and interest rates are still lagging behind

Source: Bloomberg; National Bureau of Labor Statistics; from IMF



Today's outlook – what shapes our strategy?

- Short term, we see storm clouds as US slows and OECD leading indicator drops
- Long term, emerging markets should continue to benefit from the shift in opportunities and risks

Investors in emerging markets are in the right place



Likely to get worse before it gets better

An about-face by a concerned IMF

"I don't think we would get rid of this crisis with just monetary tools – a new fiscal policy (in the US and China) is probably today an accurate way to answer the crisis"

-Dominique Strauss-Kahn, Head IMF

"It is possible that pessimism will recede as declining rates and dollar increase demand. It is more likely that the situation will deteriorate further as perceptions of lower growth increase credit spreads and risk premiums, and reduced lending and spending exacerbate pessimism about growth"

-Lawrence Summers, former secretary of the Treasury

"China will be facing a hard time this year"

-Wen Jiabao, Premier of China



63

The world is caught between lower growth and higher inflation

United States	-2%	Border-line recession
Europe	-1%	No oomph
Japan	-0.5%	Domestic respite
Emerging Markets	-1%	Affected
World	-1.25%	
Global inflation	+1%	Food
Interest rates	Mixed	A problem

- *Significant slowdown but no global recession*
- *Central banks torn*
- *Companies: facing slower sales and lower margins*



64

The United States faces major challenges

- Boom in financial industry is over
- A serious slowing is unavoidable and a real recession likely despite bail-out efforts
- Housing recession on two coasts, loss of competitive edge in rustbelt, erosion of leadership in technology and IT
- Undermining of "global superpower" and "safe haven" status means lower dollar and higher borrowing costs

U.S. now only 25% of global economy, and rest of the world "de-coupling" (but not yet "un-coupled")



65

Investors are more pessimistic than last year

- Emerging markets are not yet the new “safe haven”
- Less confidence in “de-coupling” as it is put to the test
- Markets like India and China H shares are heavily dependent on foreign investment, even with more domestic and intra-EM investment
- Exports from emerging markets (including China) are slowing as global trade comes down
- Fed rate cuts and fiscal stimulus are not going to prevent a U.S. slowdown (or even recession)
- The mood among investors has turned

A new, more volatile, less positive environment



66

The meltdown was not unexpected

- The only surprise was how long it took markets to recognize the impact of the American financial crisis and global slowing
- Brokers and investors have been reluctant to downgrade their earnings forecasts but will soon cave
- We will remain in a bear market for a while
- Markets are likely to overshoot on the downside, creating buying opportunities
- Emerging markets are coming back closer to fair value again

For the long-term, fundamental investor, things will begin to look more interesting again in emerging markets



67

The nightmare scenario

Simultaneously:

1. Led by a housing recession, U.S. economy goes into a serious recession, dollar drops, imports fall
 - Housing and credit problems spread to U.K., Spain, etc in Europe
 - Global liquidity evaporates as bankers focus more on risk and global economy slows
2. Inflation forces China to rein in economy to “cruising speed” or below
 - market bubble reverses
 - fears that the leading importer of commodities slows



68

...even if mitigating factors remain

- Outsourcing is here to stay
- Emerging markets are now **much less dependent** on United States than in previous economic downturns
- Intra-emerging market trade and investment is **booming** as consumer and infrastructure spending catch up
- Europe has **overtaken** U.S. as destination for exports of emerging markets



Summary of Outlook

1. The “American financial crisis” shows signs of being contained – but it is not over yet
2. The worst part of the dollar slide is likely behind us
3. Even heavy Fed action can’t mask the credit squeeze (In sharp contrasts to last year’s ebullient liquidity)
4. The impact on the global economy and world trade is *slowly* becoming more visible
5. Earnings downgrades are only starting
6. Emerging markets stocks are now fairly valued but markets typically overshoot and current bear market is not quite over



Top-down outlook for 2008

- Growth will be slower – and disappointing – everywhere, including emerging markets
- Inflation will be more of a problem than thought (food, earlier easy money, free lunch)
- Emerging markets are quietly tightening while the U.S. is forced to loosen (China, Brazil, Mexico, etc)
- Volatility and corrections in markets (including emerging markets) are not yet over

Perhaps light at the end of the tunnel by year-end



Confidence in the long term future

- Our caution is **short** term
- The long term future for emerging markets looks excellent
- Local and foreign investors will continue to invest more
- Most investors remain under-invested
- Neutral weighting for emerging markets should be about 20-25% of equities



72



End



73
