# Why Invest in Asia

Q4 2013

## Executive Summary

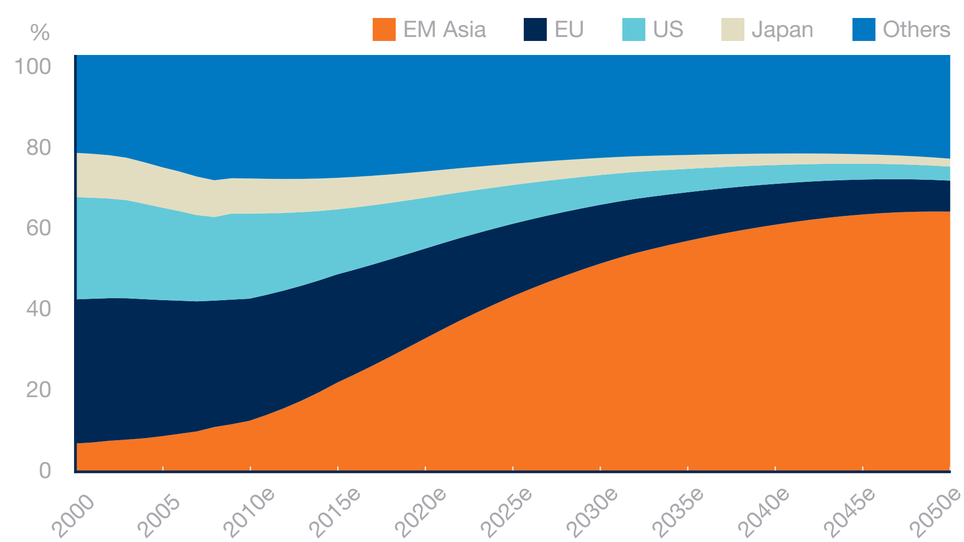
With rapid economic growth in Asia, we have repeatedly emphasized the importance and opportunities of rising consumption in the region. We continue to see values in the region's increasing consumption levels and the inevitable consumption balance shift towards the emerging markets from developed markets. We view this as a long-term sustainable trend backed by the following factors:

**Continued efforts for urbanization:** With Asia undergoing government and economic reforms, nations are putting increasing emphasis on the importance of urbanization, with a rapid expansion of spending and development plans being undertaken in order to speed up the process. Income levels and per capita consumption ratio gaps between urban and rural residents are still wide but it is hoped that government-led programs aiming to increase urbanization levels will improve income levels and that this momentum will further accelerate the global consumption balance shift towards the region.

**Emerging middle class:** Increasing urbanization will sustain economic growth and lead to a rise in income levels, underpinning the growth of middle class in the region. Asia's middle class is forecast to triple by 2020, meaning the majority of the global middle class will reside in Asia within less than 10 years. Higher living standards and propensity to spend, increasing aspiration and demand for both better and healthier lifestyles will all contribute to an acceleration in consumption.

**Favorable demographics:** We strongly believe that factors such as high working populations and low dependency ratios mean that the long-term consumption growth story in the region is sustainable. Favorable demographics mean that an expanding middle class and corresponding rise in consumption are unlikely to be short-lived trends.

**Share of Global Middle Class Consumption**




Source: Kharas & Gertz, estimates as of 2010

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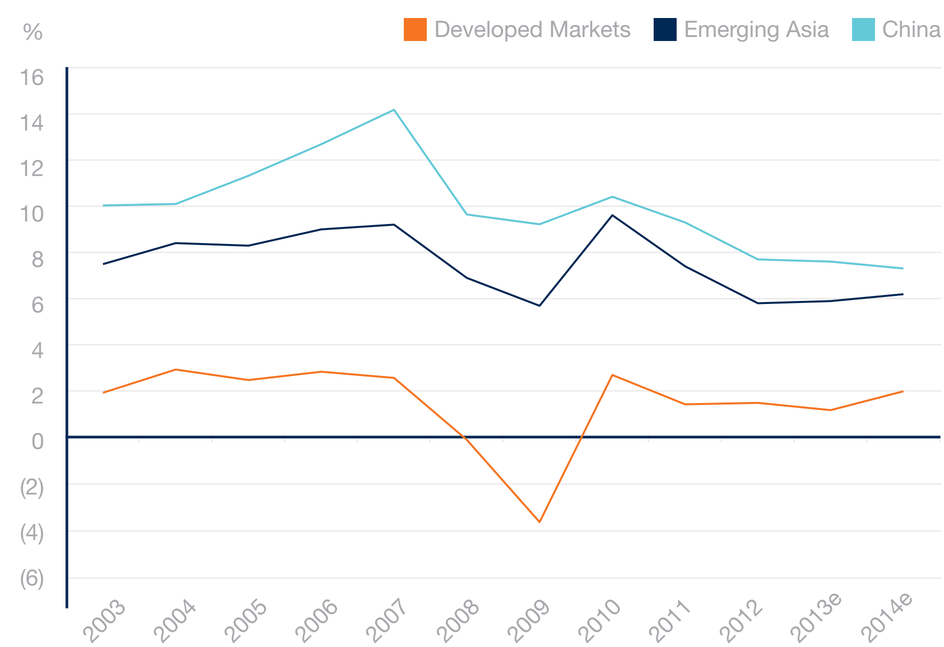
Building on principles

**Growth prominence of Asian equity market:** Equity market capitalization-to-GDP ratio in Asian markets is still significantly lower than that of their developed market peers. Relative to the size of the equity markets, Asia is still not being fully represented in investors' portfolios. Asian economies have improved their public sector balance sheets immeasurably and maintained stable levels of international reserves in spite of the recent global economic turmoil. Sufficient room for growth (i.e. market maturation), supported by the region's solid fundamentals, will underpin further upside in the Asian equity market.

## **Consumption Balance** – A Shift towards EM, Asia in particular

### Figure 1. Asia & Chinese GDP growth

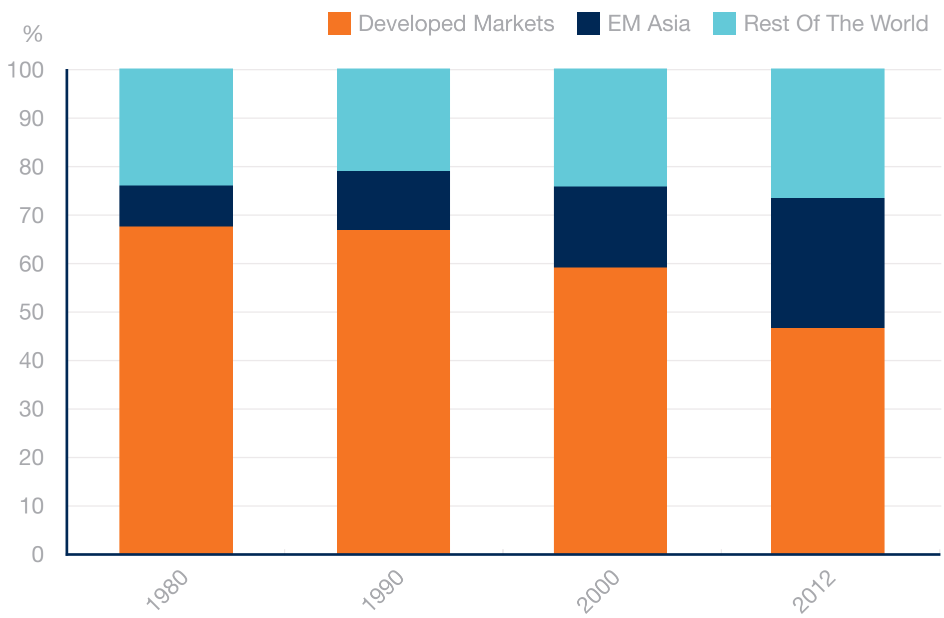



Source: IMF, as of Oct 2013

For the past decade, the rapidly expanding Asian economy and its increasing impact on the global industry have attracted wide attention from global investors. As witnessed, over the past years, Asian economies have grown at an unprecedented pace, led by China posting GDP growth at CAGR 14.5% over the last two decades. During this period, contribution from the Asia ex Japan region has also sharply expanded, accounting for 68.1% of world GDP growth in 2011 compared to an average of 34.5% in the 90's[1] . Not surprisingly, Asia is increasingly becoming a core component of Global Investors' portfolios.

[1] IMF, Mirae Asset Global Investments, October 2012

**Figure 2. World Output Share**



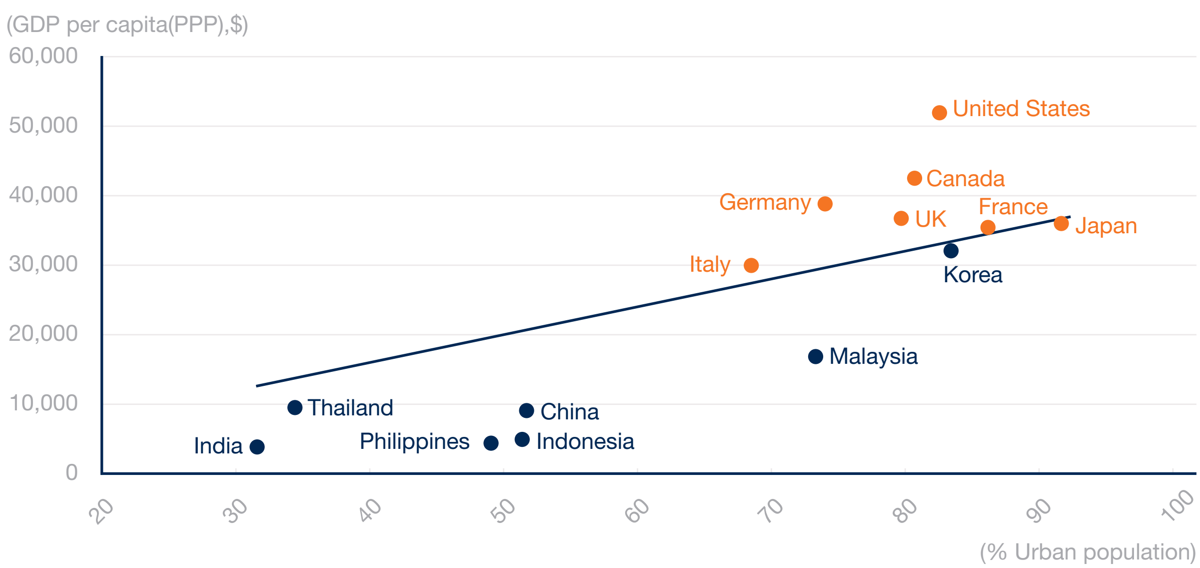

Source: IMF, as of Oct 2013, Based on PPP valuation of country GDP

In recent periods, amid lingering uncertainties over global economic growth, the fear that waning global demand may cause a deterioration in the fundamentals of the Asian economy have raised concerns on the sustainability of the region's economic growth as well as its investment attractiveness. In this report, we reiterate our view that a shift in the global consumption balance toward emerging markets, Asia in particular, is inevitable, backed by unexploited potential evident in the region's economies. We also demonstrate three key factors that will drive the consumption balance shift: 1) continued efforts for urbanization; 2) emerging middle class; and 3) favorable demographics.

## Urbanization

It is well known that urbanization, if properly handled, can support a nation's economy through increases in consumer demand as well as providing the advantage of clustering skilled workers in urban areas. Already we have seen evidence of this in Asia with increasingly urbanized societies reinforcing the region's economic growth.

**Figure 3. Urban population versus GDP per capita (PPP) (2012)**



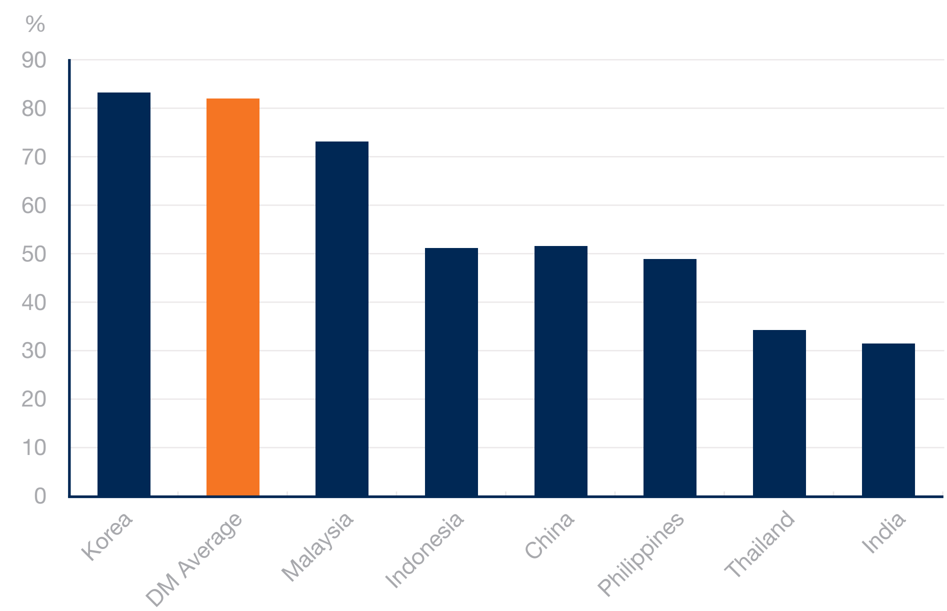

Source: IMF, World Bank, as of 2012

Yet, in most Asian countries' the urbanization rate still remains at a significantly lower level relative to developed countries. As an example, as of 2012, China's urban population stood at 699mn, 51.8% of the total population. The case is similar for other developing Asian economies. India and Indonesia's urban population remains only 31.7% and 51.4%, respectively, far lower than the developed markets' average urbanization rate of 82.3%[2] .

## Governments pushing the momentum

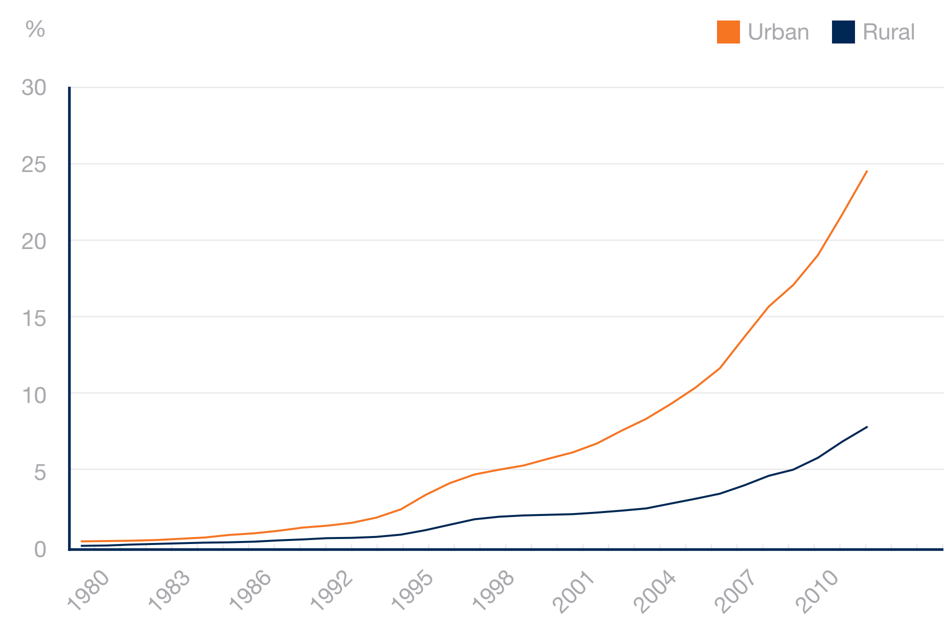
Many Asian countries are undergoing major changes such as government transition and economic reforms. Notably, regional leaders are increasingly placing higher emphasis on the urbanization process and expanded infrastructure investment. In China, with a once-in-a-decade leadership transition, the balance of economic growth has become one of the government's top priorities. In order to further speed-up the urbanization process, the National Development and Reform Commission (NDRC) of China announced approvals for infrastructure projects that are estimated at more than RMB 1.0tn (around USD157bn), approximately a quarter of the total size of the massive stimulus package unleashed back in 2008 and 2.1% of the nation's economy. With these projects, the new government is targeting to double the nation's output by 2020 and achieve an urbanization ratio of 65% by 2030.

**Figure 4. Comparative Urbanization Rates (2012)**




Source: World Bank, as of 2012, Averages are GDP-weighted

**Figure 5. Urban vs. Rural households per capita disposable income- China**




Source: CEIC, as of 31 Dec 2012

[2] World Bank, 2012

Similar efforts have been made by other major Asian countries. In Indonesia, the government announced plans to invest INR3,000tn (©USD309bn) by end of 2014 on infrastructure, manufacturing facilities and projects including dams as part of its 2011-2025 development plan. The Indian government outlined a series of infrastructure investments including port projects worth USD6.3bn for the financial year through 2013 and an investment target of US$ 3.6bn for Mumbai's rail and airports.

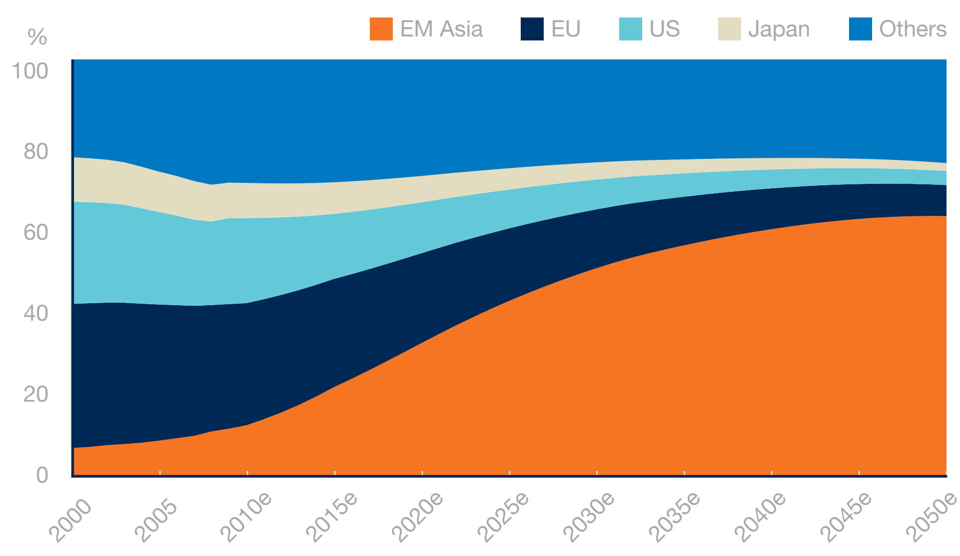
*With the urbanization process once again gaining strong momentum, we expect to see increasing asian consumer demand and a further acceleration of the shift in the global consumption balance towards the region.*

In Asia, income and wealth levels between urban and rural residents are still wide. According to the National Bureau of Statistics in China, the per capita disposable income ratio of China's urban residents to rural residents is about 3.3 to 1[3]. Moreover, according to the State Information Center of China, a one percentage point increase in the urbanization ratio can generate RMB100bn (USD15.7bn) in consumer demand[4]. Thus, **with the urbanization process once again gaining strong momentum, we expect to see increasing Asian consumer demand and a further acceleration of the shift in the global consumption balance towards the region.**

## Emerging Middle Class

Economic growth accompanied by a rise in income growth has already led to the emergence of a wealthy middle class in the Asian region. This trend is expected to continue, led by China and India. A study by the OECD predicts growth of the global

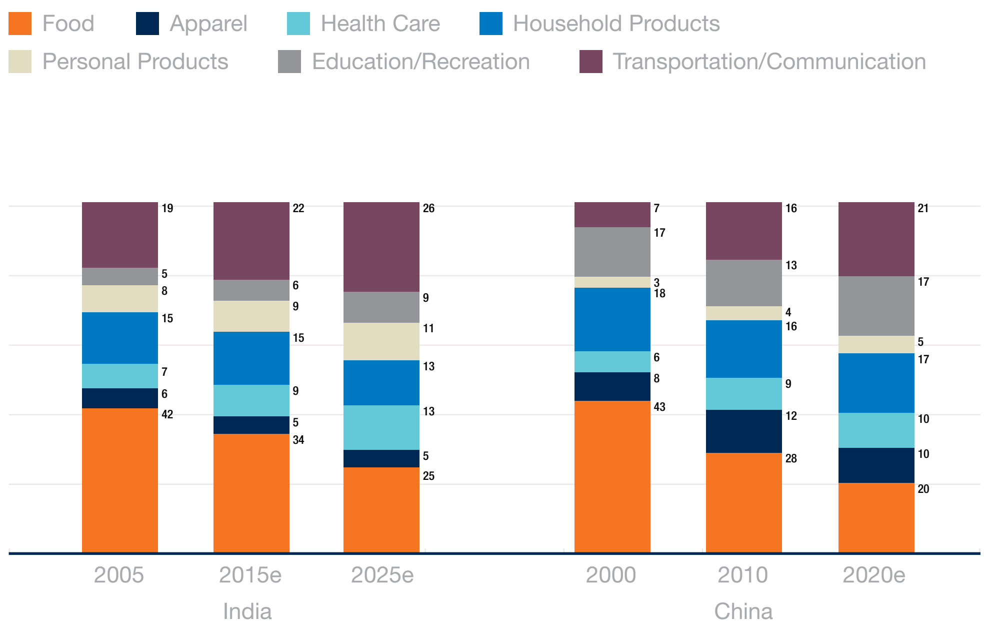
**Figure 6. Share of Global Middle Class Consumption**




Source: Kharas & Gertz, estimates as of 2010

[3] CEIC, December 2012
[4] Niu Li, Reform and Urbanization to Power China's Economic Growth, China Focus, 15 January 2013.

**Figure 7. Share Forecast of average household consumption – India and China**




Source: McKinsey Global Institute, as of Mar 2011

middle income class from 1.8 billion people in 2009 to 3.2 billion in 2020, of which over 80% would come from Asia. The Asia-Pacific middle class[5] who only accounted for 28% of the world's total in 2009 would expand to 54% by 2020[6].

The shift in demand is striking as well. Demand from the Asia-Pacific middle class may grow from US$ 5tn in 2009 (23%) to US$ 15tn by 2020 (42%); exceeding that of North America at US$ 6tn (17% of global demand)[6]. With higher living standards and propensity to spend, more money will be spent on discretionary goods and services and less on necessities. This transition is already in progress. According to World Bank data, between 2000 and 2011, mobile cellular subscriptions per 100 people in China and India have increased from 7 to 73 and from 0 to 72, respectively. Televisions and automobiles are no longer exclusively for the affluent, but have become the next necessity in ever evolving everyday lives. Moreover, Asian consumers are trading-up in discretionary items, such as apparel, cosmetics and household goods, to high-end brands, as witnessed through the 33% year over year growth of the Asian luxury market[7]. It is such increasing aspirations and demand for a better lifestyle that will further accelerate the rise in consumption, even amid sluggish economic growth.

[5] Middle class defined as those households with daily expenditures of between US$ 10 and US$ 100 per person.
[6] Homi Kharas, The Emerging Class in Developing Countries, OECD Working Paper No. 285, January 2010.
[7] PWC, Market Luxury Vision - Challenges and opportunities in the new luxury world: winners and strategic drivers, 2012.

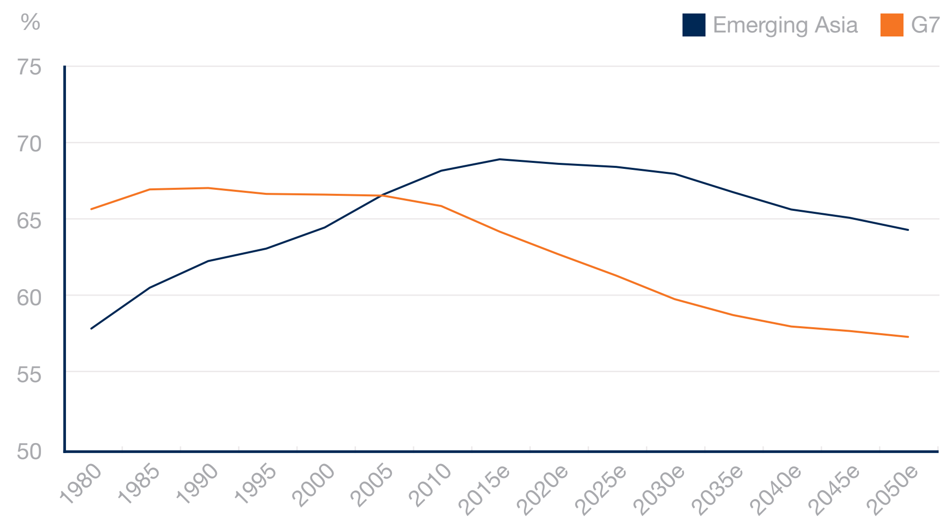
## Favorable Demographics

It would be meaningless if the emerging consumer class of Asia is merely large but unsustainable. It is indeed the favorable age structure of the growing consumer class in Asia that further supports the shift in the balance of global consumption to Asia.

Higher working-age ratios and lower dependency ratios are crucial in economic growth. Growing labor forces facilitate higher economic and per capita income growth, providing room for a faster pace of consumption growth compared to that of developed markets. This also holds true for a low total dependency ratio[8].

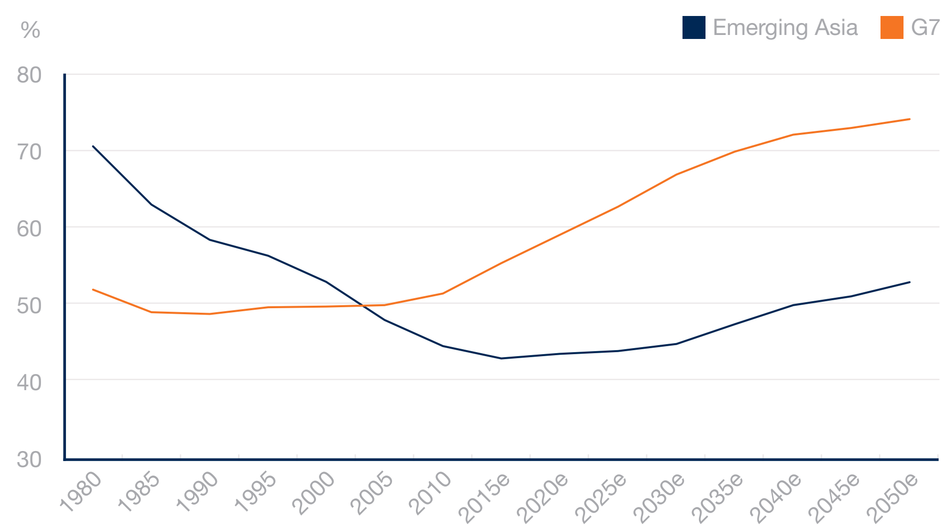
According to the UN's World Population prospects, by 2015, more than half of emerging Asia's population will be in the productive age group (15-59) who are crucial in both the production of goods and services as well as driving increasing consumption levels. Moreover, given lower dependency ratios compared to those in developed markets, i.e. less need to support dependants, long-term consumption growth in the region is expected to be sustainable.

**Figure 8. Working Population Ratio**




Source: World Population Prospects: The 2012 Revision, as of Aug 2013
Note: Percentage of age group of 15-64 divided by total population

**Figure 9. Total Dependency Ratio**




Source: World Population Prospects: The 2012 Revision, as of Aug 2013
Note: Percentage of non-working age group divided by working age population

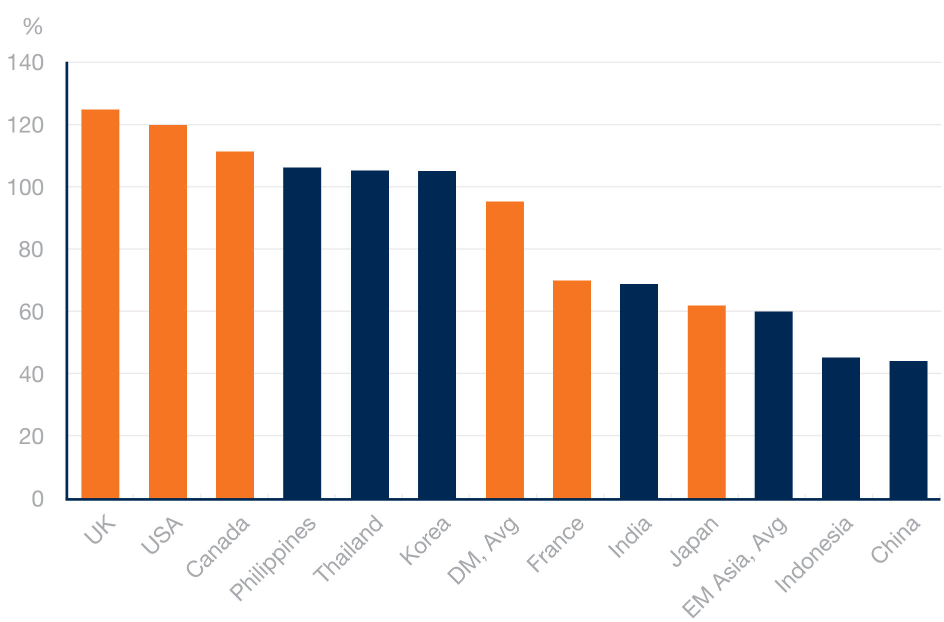
[8] Mirae Asset, Demographics in Emerging Markets: Hope or Hype, April 2011.

# Growth Prominence of Asian Capital Market

Unfortunately, strong economic growth does not necessarily correspond to strong growth in the equity markets as various factors including capital market composition and market listing practices also have an effect. Thus it would be over simplistic to say that the Asian capital markets will expand merely because the economy is growing.

However, there are two data points that suggest we are highly likely to see strong growth in the Asian capital markets. First, despite the outperformance of the Asian equity markets over the past decade, the equity market capitalization-to-GDP ratio is still significantly higher in developed markets. Second, there is evidence that a higher economic growth rate in fact does tend to imply a larger market capitalization over the longer term and if the equity markets of the developed world can be used as a benchmark, one can expect the market capitalization-to-GDP ratio of Asian markets to increase as those economies mature[9].

**Figure 10. Market cap-to-GDP ratio (2012)**



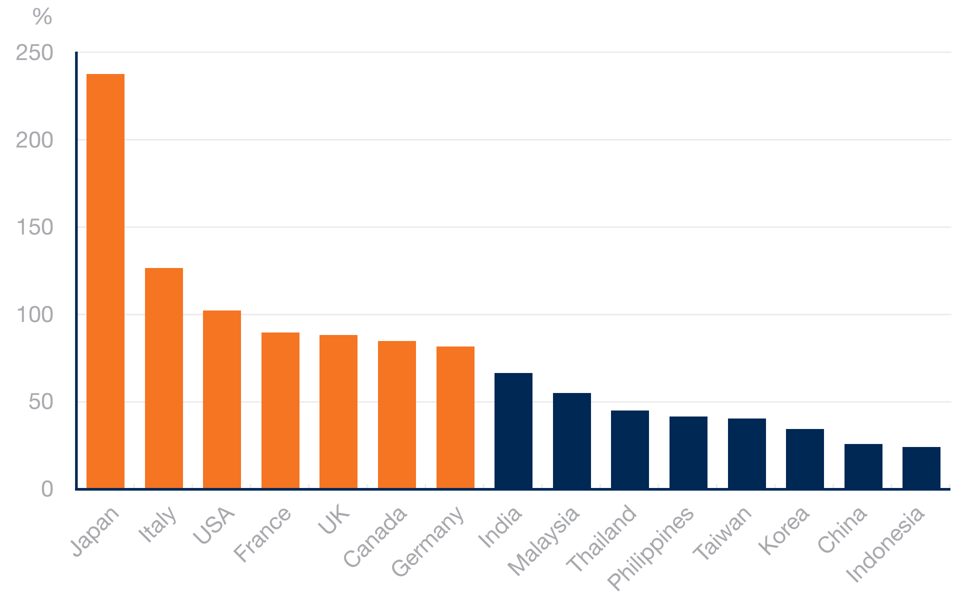

Source: IMF, World Bank, as of 2012, Averages are GDP-weighted.

The market capitalization-to-GDP ratio of Emerging Asia excluding Taiwan is only 59.8% compared with 94.7% in developed countries in 2012[10]. Assuming increased demand in Asian equities would lead to market maturation and further accelerate the revaluation process between the market capitalization-to-GDP ratios of developed and Asian economies, growth potential for these markets look strong.

Higher market capitalization-to-GDP ratio may be achieved through increased IPO activity, issuance of additional stock by existing companies and price increases. Accordingly, market maturation would supply greater liquidity and new capital inflows into the region, further increasing the upside potential of the Asian equity market.

[9] Mirae Asset, Seven Reasons to Consider Emerging Markets, November 2011.
[10] World Bank, 2012, GDP-weighted average

## Figure 11. Gross Public Debt to GDP (2012)




Source: IMF, as of 2012, most recent full-year available data

## Figure 12. S&P Long-term foreign currency sovereign debt rating

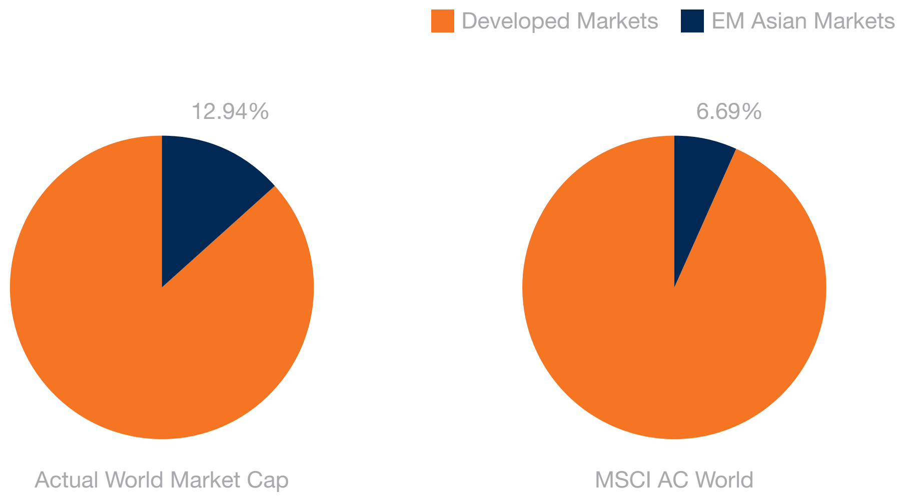
| Country | Current | 2000 |
|---|---|---|
| China | AA- | BBB |
| India | BBB | BB |
| Indonesia | BB+ | CCC+ |
| Korea | A+ | BBB |
| Malaysia | A- | BBB |
| Philippines | BBB- | BB+ |
| Taiwan | AA- | AA+ |
| Thailand | BBB+ | BBB- |

Source: Bloomberg, as of 31 Oct, 2013

Furthermore, it is necessary to emphasize that the current Asian economies in no way resemble those of the late-90s. After the Asian Financial Crisis, Asian policy makers have learned the importance of maintaining a healthy public sector balance sheet and stable levels of international reserves. Unsurprisingly, Asian economies' debt-to-GDP ratio is substantially lower than that of their developed market counterparts. Though the ratio may inevitably increase in the long-run as demand for social security in the region increases, in the short-term, Asian economies still seem able to maintain a stronger fiscal condition relative to the developed world.

Risks such as default, high volatility, and low transparency have been significantly reduced during the past decade, as witnessed in the enhanced credit ratings of Asian countries. It is particularly important and notable that six out of eight Asian economies have reached investment-grade status, critical in reducing the financing costs of emerging market governments as well as companies operating in the region.

**Figure 13. World Market Cap vs. MSCI AC World Weight**




Source: Bloomberg, MSCI, as of 31 Dec 2013

## Acknowledging the Gap

Rising investor interest in Asia is easily noticeable through the increased fund flows into the equity markets witnessed over the past few years. However, questions still remain over the level to which Asia will be represented in investors' portfolios. The market capitalization of the Asian markets accounts for 12.94% of the world's total, while it only accounts for 6.69% of the MSCI AC World Index . As much as an expanding economy can be no guarantee for growth in equity markets and thus increased allocation in investors' portfolios, if there is a significant gap between actual market capitalization and average asset allocation to that region, it is safe to assume the region's exposure will likely expand. And given the current strong fundamentals in Asia, it is likely to be soon.

[11] Bloomberg, MSCI, December 2013

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