Consumption Growth: Investing in Today's Emerging Markets

March 2018

MIRAE ASSET GLOBAL INVESTMENTS

Introduction

OUR INTENT IS TO DEMONSTRATE HOW RISING NUMBERS OF CONSUMERS IN THE EMERGING MARKETS ARE SET TO TRANSFORM THE GLOBAL ECONOMIC LANDSCAPE OVER THE COMING DECADES, AND THAT THIS PRESENTS A UNIQUE INVESTMENT OPPORTUNITY.

Consumers in the U.S. and in other major developed economies have historically been a key source of global demand and an important driver of global growth. However, in the past decade, global growth has primarily been coming from consumers in the emerging markets and this trend is expected to continue for the foreseeable future. We are all familiar with the Chinese growth story and the increasing popularity of the emerging markets with investors but the question we will seek to answer in this paper is: whether the rise of the emerging market consumer is a sustainable investment theme and where do the specific opportunities lie?

There is one statistic that we believe places into context the scale of the changes currently happening globally. Research reveals that the number of middle class consumers in the emerging markets will reach 2.3 billion by 2020; this is compared to 77 million Baby Boomers in the U.S.[1] — a generation widely acknowledged to have had a profound and lasting impact on both economic output and domestic consumption in the developed world. In this white paper we will go beneath the surface to examine the drivers behind this emerging middle class and how increasing urbanization and positive demographics are all pointing to significant income growth potential.

We will also explore the impact this income growth will have on global consumption levels and spending patterns. Global consumption is forecast to reach $62 trillion by 2025, twice its 2013 level, with half of this increase coming from the emerging markets.[2] As investors, we need to know who will be the winners from this exponential growth in consumption and what the key factors are when trying to understand an investment landscape that is fundamentally different to that which we have seen previously.

In this paper we will outline the fundamental pillars supporting the expansion of the middle class in the emerging markets and how this will translate into the emerging market consumer becoming the dominant force in the global economy in the coming decades.

There can be no guarantee that any strategy (risk management or otherwise) will be successful. All investing involves risk, including the potential loss of principal.

[1] US Census Bureau, UN Department of Economic and Social Affairs; The Brookings Institution, "The Unprecedented Expansion of the Global Middle Class", 2017, and Mirae Asset.
[2] McKinsey & Company, "Global growth, local roots: The shift toward emerging markets," August 2017.

Four Factors of Consumption Growth

THERE ARE STRONG FUNDAMENTAL FACTORS SUPPORTING THE EXPANSION OF THE MIDDLE CLASS IN THE EMERGING MARKETS. THESE FACTORS ARE ENABLING THIS IMPORTANT AND GROWING SEGMENT OF THE POPULATION TO BECOME A DOMINANT FORCE IN THE GLOBAL ECONOMY IN THE COMING DECADES. WE BELIEVE THE FOUR KEY FACTORS SUPPORTING THIS TREND ARE 1) URBANIZATION; 2) INCOME GROWTH; 3) FAVORABLE DEMOGRAPHICS; AND 4) CONSUMPTION-LED ECONOMIC GROWTH.

Urbanization

Mirae Asset sees urbanization within emerging markets as one of the most important drivers of consumption growth. As people shift from rural areas to urban districts and seek new professions, higher wages and a better quality of life, they have access to a larger number of socio-economic opportunities. With greater job prospects and higher wages, the rural farmer becomes the new middle class consumer. Middle class is defined as people earning between $11 and $110 per day (or $4,015 to $40,150 per annum), adjusted for purchasing power parity.[3]

Historical data shows that the process of increasing urbanization significantly contributes toward economic growth. Every five-percentage-point increase in the share of citizens living in urban areas generates a 10% increase in per-capita economic activity.[4] Countries with high urbanization levels have the highest per capita gross domestic product (GDP)[5] and higher individual incomes in absolute terms relative to peers.[6] Through the process of urbanization, cities increase their levels of economic activity which in turn results in greater consumption.

The current urbanization gap between emerging countries and developed countries is still sizable, but is declining. As the table shows, urbanization in developed countries was fairly saturated with 78.3% of the population living in cities in 2015, and although the process of urbanization will continue to take place, it will occur at a slower pace. The United Nations projects that by 2050, the population living in cities in developed countries will reach 85.4%. In emerging economies, however, only 49.0% of the population lived in cities in 2015. The urban population in these emerging economies is expected to increase to 63.4% by 2050.

PERCENTAGE OF POPULATION RESIDING IN URBAN AREAS

MAJOR AREA OR COUNTRY	2015	2025	2050
Developed Countries	**78.3**	**80.4**	**85.4**
Germany	75.3	77.5	83.0
Japan	93.5	96.3	97.7
UK	82.6	84.8	88.6
US	81.6	83.3	87.4
Emerging Countries	**49.0**	**54.0**	**63.4**
Brazil	85.7	87.8	91.0
China	55.6	65.4	75.8
India	32.7	37.0	50.3
Indonesia	53.7	60.3	70.9
Mexico	79.2	81.8	86.4
Russia	74.0	75.3	81.1
South Africa	64.8	69.4	77.4
South Korea	82.5	83.8	87.6
Thailand	50.4	60.4	71.8

Source : UN Department of Economic and Social Affairs (DESA), World Urbanization Prospects.

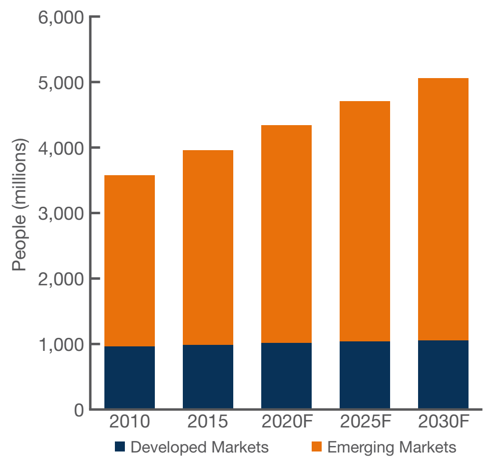
[3] Brookings Institution, taking inflation into account and in 2011 PPP terms.
[4] Credit Suisse, Emerging Market Research Institute.
[5] Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.
[6] UN-HABITAT, "Urban Trends: Urbanization and Economic Growth".

In terms of total population numbers, the absolute number of city dwellers in emerging countries (at almost 3 billion) already far exceeds the urban population of developed countries (around 1 billion). By 2030, city populations in emerging markets are expected to reach 4.0 billion people, or about 4 times larger than those in developed countries.

It is this growth in urbanization in the emerging markets that we believe is setting the stage for a multi-decade consumption boom. According to the McKinsey Global Institute, 91% of global consumption will come from cities between 2015 and 2030. The global distribution of consumption wealth is already tilting towards the emerging markets, with consumers living in emerging market cities contributing 56% (or $14.1 trillion) to global consumption growth, compared to 35% (or $8.8 trillion) for consumers in developed market cities for the 2015-2030 period.[7]

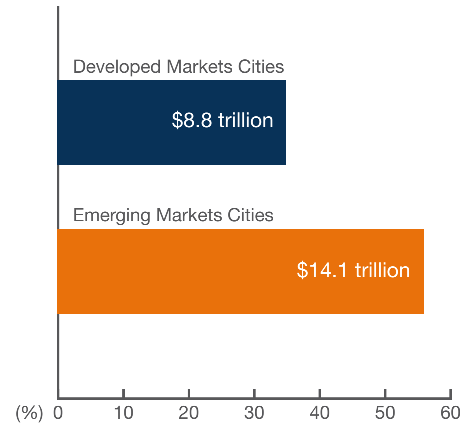
The process of urbanization that has historically driven the growth in the developed market economies is now happening in the emerging markets but on a far greater scale, creating a whole new class of consumer.

URBAN POPULATION



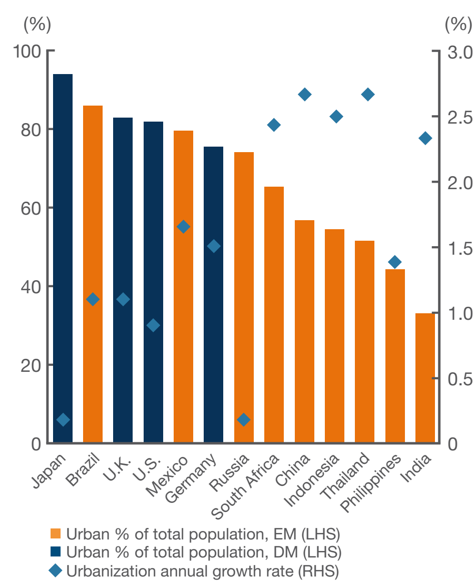
Source: UN DESA, Population Division.

URBAN CONTRIBUTION OF GLOBAL CONSUMPTION GROWTH, 2015-2030



Source: McKinsey Global Institute, "Urban World: The Global Consumers to Watch," 2016.

URBANIZATION RATES OF SELECT COUNTRIES (2016)



Source: World Bank.

Estimates and forecasts are only projections and not guarantees.

[7] McKinsey Global Institute, "Urban World: The Global Consumers to Watch", 2016.

Income Growth

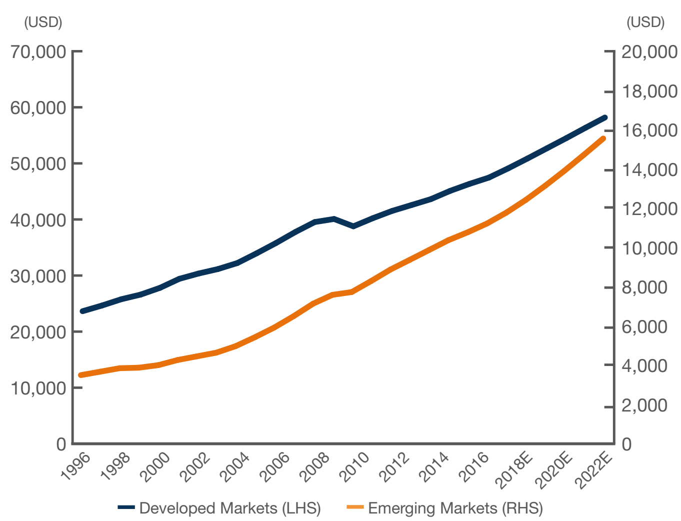
With a whole new class of consumer, driven by urbanization, income growth is a key determining factor of the overall consumption level. Historically, populations in the emerging markets have spent most, if not all, of their income on basic necessities such as food and housing. However, as incomes rise, the proportion of income spent on basic necessities gradually decreases while the proportion spent on discretionary items, such as cars, clothing and appliances, increases. In other words, rising incomes in the emerging markets are transitioning a significant proportion of the population out of poverty and into middle class status.

A better quality of life usually comes with middle class status. One way to measure a country's standard of living is GDP per capita. GDP per capita in emerging markets is still low relative to developed markets but the gap is closing. In 2016, emerging economies generated over $11,000 of GDP per capita, a significant increase from $6,500 and $3,670, 10 and 20 years ago, respectively. GDP per capita in the emerging markets is expected to rise to around $15,500 by 2022, according to estimates from the International Monetary Fund (IMF).

Income is extremely influential when it comes to moving up the status ladder and wages have steadily grown in the emerging markets at an average annual rate of 5.9% from 2006 to 2015.[8] Asia has led the growth in wages. In 2015, real wages in Asia grew 4.0%, significantly above the global average of 1.7%. As was experienced in developed countries, as disposable income rises consumer tastes become more sophisticated and brand awareness increases, leading to more spending on discretionary items.

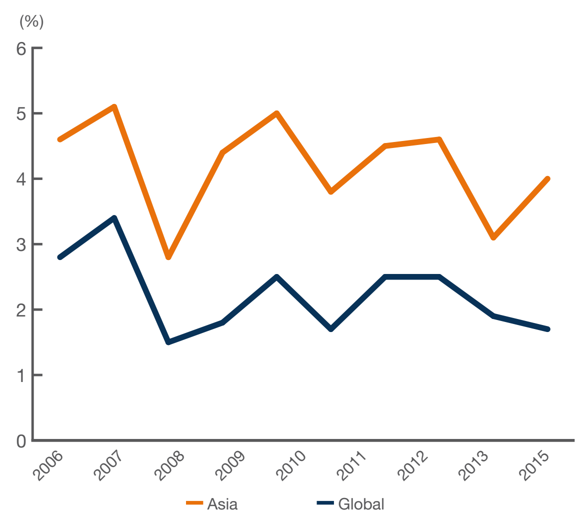
Rising income levels combined with a growing, newly minted consumer class strongly points towards the emerging markets being the natural driver behind global consumption. Companies with operations in the emerging markets have already been beneficiaries of this income growth yet we believe we are still in the early stages of this phenomenon.

GDP PER CAPITA, PPP



Source: IMF, World Economic Outlook Database, October 2017.

GROWTH OF AVERAGE REAL WAGES IN ASIA AND THE WORLD



Source: ILO: Global Wage Report 2016/2017.

Estimates and forecasts are only projections and not guarantees.

[8] International Labour Organization (ILO): Global Wage Report 2016/2017. Emerging economies include: China, India, Turkey, Russia, South Africa, Brazil, Indonesia, Saudi Arabia and Mexico.

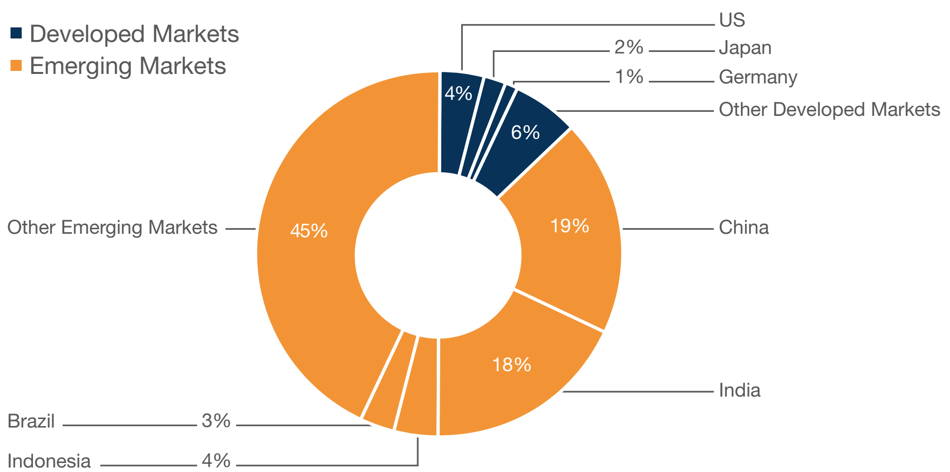
Favorable Demographics

If the phrase "people are our greatest asset" is correct, then the emerging markets are indeed rich. In 2016, the population in emerging markets accounted for more than 85% of the world's population. India and China alone accounted for a total of 2.7 billion people, or 37% of the world's population. According to estimates from the United Nations, the world will have more than 8.5 billion people by 2030, up from 7.4 billion in 2016. A significant portion of this increase will occur in the emerging markets.

Our thesis is not based purely on the absolute population numbers in the emerging markets but more specifically on the positive demographics. Despite their differences, there are two key demographic commonalities across many emerging market countries, namely that these populations tend to be younger than their developed market counterparts and also have increasing levels of education.

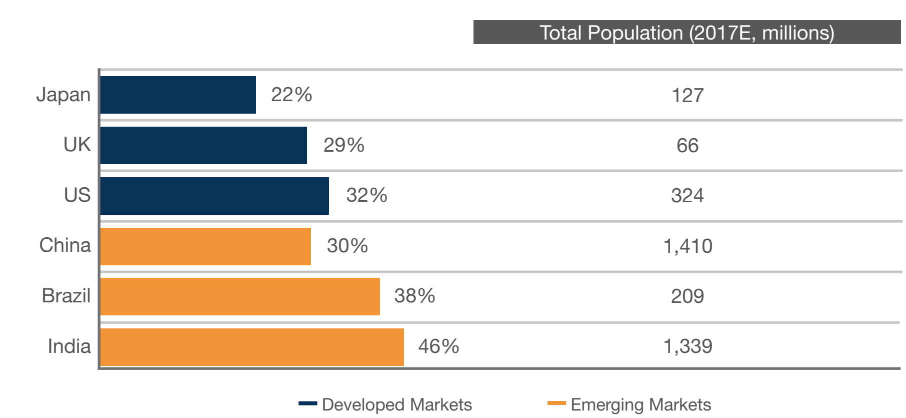
The populations in many developed countries, such as Japan, the U.K. and the U.S. are aging, with the situation most pronounced in Japan. In the U.S., the Baby Boomers who were once drivers of consumption growth are now entering retirement and exiting the labor force. The chart below highlights the extent of this situation with the percentage of the population under the age of 25 at 38% and 46% in Brazil and India, respectively, compared with 32% in the U.S. and only 22% in Japan. Positive demographics such as these are evident across most of the emerging markets.

WORLD POPULATION (2016)



Source: World Bank. Totals may not add up to 100% due to rounding.

POPULATION UNDER THE AGE OF 25 (2017E)



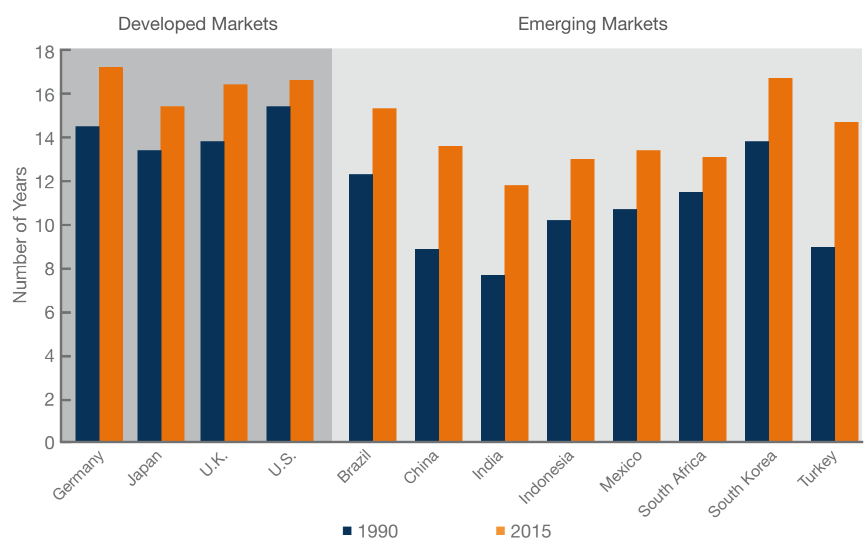
Source: UN DESA, Population Division. World Population Prospects: The 2017 Revision.

Estimates and forecasts are only projections and not guarantees.

Moreover, the workforce in the emerging markets is not only large and young, they are also attaining higher levels of education than previous generations. Although developed countries still have the highest average number of years of education per person, greater emphasis is being placed on education within emerging markets. As the chart below illustrates, the number of years of education in emerging economies is rising. Emerging economies are also experiencing a rise in the percentage of their populations who are pursuing higher education. For example, 70% of the population in South Korea between the ages of 25 and 34 had university degrees in 2016, up from just 36.9% in 2000.[9]

A younger, more educated workforce tends to be more innovative and is better at leveraging technology, both of which are vital in boosting productivity and generating growth for an economy. In addition to being a powerful force in the labor market, these younger populations will also play a significant role as consumers going forward. With more of the young population entering into the peak of their earnings cycle over the coming decades, backed by the two key factors of youth and education as described above, we are almost certain to see a corresponding rise in consumer spending.

EXPECTED YEARS OF SCHOOLING FOR SELECTED COUNTRIES



Source: UNDP, Human Development Reports. Data refers to 2015 or the most recent year available.

[9] Organisation for Economic Co-operation and Development (OECD), Population with tertiary education.

Consumption-led Economic Growth

In the past, a number of emerging economies have enjoyed rapid economic growth, supported by exports and investment. As international trade proliferated in the late 1990s and early 2000s, emerging market countries positioned themselves as labor-intensive destinations owing to their low labor costs and abundant workforces, providing the competitive advantage to become successful export-led economies. The subsequent high level of accumulated capital derived from exports was invested into infrastructure improvements, spurring greater industrialization and increased productivity for these emerging economies.

China is the typical example of this export-led growth model, a model that had successfully contributed to an average annual GDP growth rate of 10% from 2000 to 2011.[10] During the global financial crisis and European debt crisis, consumer demand from developed economies substantially weakened and within the context of a sluggish global economy there was a downward sequential impact to exporters in the emerging markets.

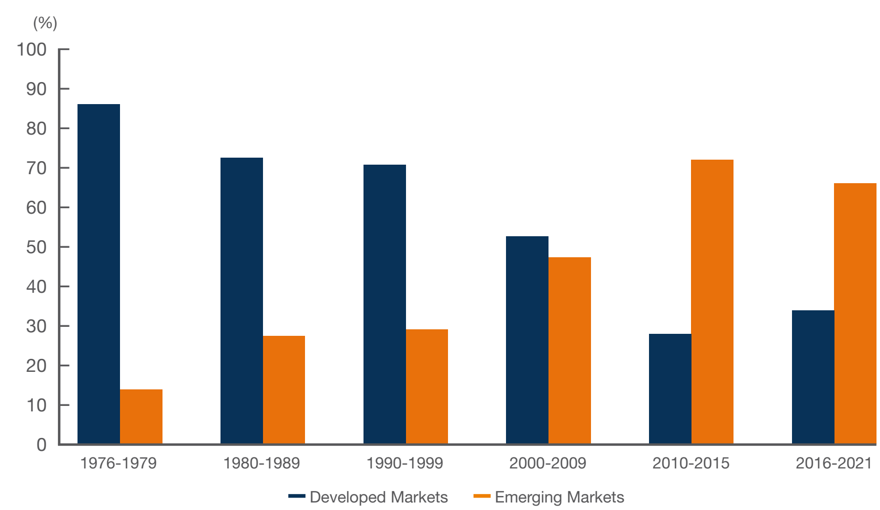
This external reliance on consumer demand in the developed markets and the inherent vulnerability to any slump in developed economies is why emerging economies are seeking to shift away from an export and investment-led growth model to one focusing on domestic spending. Policy makers in the emerging markets are well aware that the conventional export-led growth model utilized by Asian economies in the past is unlikely to be sustained over the longer-term and that economic growth increasingly needs to come from domestic consumption.

The weight of private consumption contribution to the GDPs of emerging countries may still be quite low in relative terms, but it is steadily rising. For example, household consumption in China accounted for 36% of its GDP in 2010, grew to 39% of GDP in 2016, and is projected to reach 47% of its GDP by 2030.[11]

Indeed, the collective rise of consumption in the emerging markets is already having a material impact on the global economy. According to the IMF, consumption growth predominantly came from the emerging markets during the 2010-2015 period. For the 2016-2021 period, emerging markets are expected to contribute 66% to global consumption growth, compared to 34% for developed markets.

We believe that rising consumption in the emerging markets is a multi-decade trend as policy makers in these economies continue to take steps to adjust their growth models toward one that is powered by domestic consumption.

CONTRIBUTION TO GLOBAL CONSUMPTION GROWTH



Source: IMF.

Estimates and forecasts are only projections and not guarantees.

[10] World Bank.
[11] World Bank and Morgan Stanley.

"Great Consumer" — Defined

Over the previous pages we have documented the four factors (urbanization, income growth, favorable demographics and consumption-led economic growth) that we believe are driving the rise of the middle class in the emerging markets and how we see this as a long-term sustainable trend that will lead to rapid income growth and a resultant exponential increase in consumer spending. This uptick in emerging market consumption in our view is set to have profound and extensive positive spillover effects across a wide array of sectors in emerging economies.

In response to this phenomenon, Mirae Asset has developed a unique investment strategy designed specifically to take advantage of the long-term consumption growth trends in and beyond the traditional consumer sectors. We call this investment strategy "Great Consumer®." Our belief is that there will be direct and indirect winners in the rise of the emerging market consumer and we seek to look beyond the obvious winners to identify the wide-ranging beneficiaries of this economic growth phenomenon.

Companies that operate in the consumer sectors, such as auto makers, apparel companies, luxury brands and retailers, are the obvious recipients of increasing consumer spending in the emerging markets and already we are seeing this play out. The automobile industry is already benefiting from the emerging market consumption theme and yet future growth potential is still high. Auto sales in the emerging markets reached 48 million units in 2015. By 2025, emerging market vehicle sales are anticipated to rise 45% to 69 million.[12]

History has shown that for consumers in the early stages of wealth accumulation, luxury apparel, jewelry and automobiles are the most in-demand goods. But over time, tastes and needs broaden to incorporate a wider range of services such as travel, recreation, education and health, and it is here where we see the most attractive investment opportunities. These sectors are already benefitting from the emerging market consumer, but we believe there is still much growth potential.

It is not enough though to merely highlight the industries where we feel there will be growth, the key component of the Great Consumer investment strategy is to fully understand the emerging market consumer — what drives their tastes and requirements and then what effect this will have on the companies seeking to enter the market.

Global companies naturally face greater challenges with regards to local knowledge, local channels and local tastes which are all significant entry barriers. We believe that correct local adaptation in products and services will be a key success factor. In sectors that are more regionally varied and nuanced, winners will often be the local companies, as they are better positioned to quickly exploit consumption trends.

When we also factor in additional barriers to entry such as governmental protection for local companies and the imposition of tariffs on global companies, it is clear that picking winners among peers is a complex task and requires in-depth understanding of the local markets. At Mirae Asset, our on-the-ground research and local know-how gives us a unique perspective and expert insight into the complex nature of emerging markets investing.

There can be no guarantee that any strategy (risk management or otherwise) will be successful. All investing involves risk, including the potential loss of principal.

[12] Automotive News, IHS Markit.

Disclaimer