Q & A

The Rise Of The Emerging Markets Consumer: Regional Perspectives, Global Opportunities

May 2013

Population growth in the emerging markets (EM) is a significant driver of economic growth, and with that growth comes an ever increasing middle-class. This group of consumers has the same aspirations and desires as their counterparts in the developed world — cars, gadgets, luxuries, etc. An example of middle-class growth is the fact that, in less than 20 years, GDP per capita growth in China and India should double, a quicker pace than the 50 years it took the US to double the same, and much faster than the 150 years it took in Britain.

Our panel of global emerging market investment specialists took the time to share their local insights and perspectives on this worldwide phenomenon and its impact on regional investment opportunities.

Q. What are the main drivers of the consumer boom in the emerging markets, and what is the makeup of the consumer?

STACY STEIMEL
Managing Director, Head of Latin America Equities
Santiago

A. In my region, the consumer sector is made up of working age individuals between 19 years old and retirement, but largely concentrated in the 18 to 40 range. They have formal jobs, and a majority of them now qualify as part of the middle class, which is a very big shift we have seen in recent years, with earnings of between US $3,000 and US $15,000 per year. They generally live in an urban sprawl. Households have multiple generations and are more commonly headed by women than in other parts of the emerging world. Women tend to spend more and pay on time, which really enhances the consumer story.

The Latin American consumer's spending is highly aspirational, and financial services in our region are still relatively under penetrated, which creates a lot of potential spending power into the future. Consumers tend to be much more educated than in the past, especially in Brazil, as former President Lula's successful conditional transfer program kept young children in schools, which improved both their education levels and their level of nutrition. The number of Brazilians with post secondary education has more than doubled in the past 10 years, which matches similar advances in other parts of the emerging world. This promises a productivity boost into the future, which is important for the whole 360 degree consumer story.

> *We are on the threshold of one of the biggest trade-in and trade-up cycles in global history.*

Consumption is a real macroeconomic growth driver in Latin America, and it should continue into the future. It is supported by a young population, income gains, a growing middle class, increased informalization and relatively low penetration in secondary cities.

Two-thirds of Brazil's population, which dominates our region in both population and size, is of working age. Mexico follows Brazil in size, and recent labor reforms should hike the country's productivity and support gains in potential GDP. This is something very new in Mexico. Following Brazil and Mexico are the Andean countries — Chile, Colombia and Peru. Peru has one of the fastest-growing consumer bases anywhere in the emerging world.

Catrin Haden
Vice President, Head of Emerging Europe Equities
Stockholm

A. Historically, when thinking of Europe people tend to think of cities like London or Paris, but today, Istanbul and Moscow are amongst Europe's largest cities.

Turkey and Russia are the largest equity markets within the region and have the largest consumption growth. The major difference between Turkey and Russia is their growth in population. Turkey has a young population with an attractive growth profile. We see inflows into the workforce, which means more consumers, and is beneficial for consumer growth. Russia, on the other hand, has an older population that has been decreasing for several years. Luckily, this trend is now stabilizing and very slowly reversing, driven predominantly by immigration from other countries, particularly the CIS countries, Russia's closest neighbors. Unemployment levels in Russia are low, around 5%. This adds to the fact that finding native speaking workers can be difficult. For example, if you go into a food store in Russia, you are likely to meet workers from neighboring countries like Uzbekistan or Tatarstan, rather than Russia. Immigration is serving to help Russia keep its population intact, thus helping consumer spending. Ultimately, future growth is expected to be higher in Russia than in Turkey, despite Russia's less attractive demographic outlook. This proves that consumption growth does not really have to come from population growth.

We believe that, looking forward, growth expectations for emerging Europe compares favorably to its developed markets counterparts. Yearly expectations for income growth between 2010 and 2050 are between 1% and 1.7% for developed Europe, and approximately 3% for Poland and even more for Russia. We expect Russia to overtake Germany as Europe's largest consumer market in 2020, and most probably the world's fourth largest consumer market by 2025.

Global brands are finding the Russian consumer attractive; this is due to spending being evenly spread throughout the age ranges, thus giving marketing campaigns further reach.

We also see a difference in education between the two. In Russia, education levels are higher than in Turkey. In years to come, this divide may become problematic for Turkey, as many young women may avoid moving on to higher education.

Moving onto similarities, consumer growth in Russia and Turkey are driven by several common factors. First, as consumers move up in income brackets, they tend to spend less on food in percentage terms, leaving more money to spend on housing, discretionary items and services. Urbanization and demand for housing are also contributing to the consumer growth story. In Turkey we are seeing additional factors driving this demand as a lot of older buildings need to be replaced due to the risk of earthquakes.

Another factor for growth is political stability; if people are happy with the government, they are more willing to spend. Without this stability, consumers may choose to save and not contribute to domestic growth. Therefore we expect politicians to do their best to support consumption growth in the future.

Elizabeth Soon
Managing Director, Head of Small Cap Asia ex-Japan
Hong Kong

A. There are four key factors driving consumer growth in Asia. The first factor is urbanization, which has driven the rise of GDP growth in China over the last 10 years. This has been no different than the other ASEAN nations. Looking back to the 1980s and 1990s, the ASEAN nations were dubbed the "little dragons". They grew more than 10% in GDP terms in the 1980s, which was led by the shift toward manufacturing. Foreign direct investment in manufacturing drove much of this growth, as companies from other countries began manufacturing in the region. One example is Japanese electronics and car companies that helped boost growth.

We now see a similar pattern in China with a shift from agriculture to manufacturing. This trend has actually led to a growth in wage levels. In the next 20 years, we are going to see the shift from lower-end manufacturing to high-end manufacturing, and then from higher end manufacturing to services, leading to the continuation of growth for China.

Consumption itself has also been a key factor in consumer growth. The domino impact from consumption growth has led to Chinese travelers moving across Asia, which has created growth throughout the region. For example, we have seen casinos being built in almost every part of the ASEAN region, including two in Singapore and five in Macau.

China's one child policy of the last 15 to 20 years has redefined the head of the household and created an interesting dynamic in consumer spending. For purchasing purposes, the head of the household is usually not the mother or father, but actually the child. The child makes consumer decisions, so retailers, more often than not, have to convince them to buy their product, not their parents. With this in mind, we are seeing a lot of effort directed toward children, which has led to stronger consumption in this particular area.

Another driver of consumption growth is the so-called "Alibaba effect". The rise of the IPO market has created many multi billionaires. These Alibaba billionaire,s as they are called, have been able to find wealth in a very short time span, which has led to the growth in high-end consumption.

Q. How sustainable is this consumer growth story, and what are some of the potential threats?

STACY STEIMEL
Managing Director, Head of Latin America Equities
Santiago

A. The underpinnings of the consumer story are strong and not driven by trends, so rising incomes are the most important driver in all regions, as illustrated in Figure 1.

For example, when your income exceeds US $10,000 to US $15,000 per year, you begin a lifelong consumption cycle, which is quite different than just meeting your basic needs. While rising incomes are certainly the most important driver, age, urbanization, household formation and financial leverage all play a key role in supporting the story. Consumer confidence in this realm becomes one of the most important variables. Luckily, at the moment, consumer confidence is extremely high. However, as we are well aware, the consumer can be shaken at times, and this can really affect how money is spent.

The boom in consumer spending is not absolute, and consumer confidence can weaken. The risk factors are generally

FIGURE 1 GDP: Converging To Middle Incomes

Increased Income = Greater Purchasing Power

Emerging Europe	Population (million)	1992 GDP Per Capita	2012 GDP Per Capita
Russia	142	$7,870	$17,697
Turkey	75	$6,058	$15,029
Poland	38	$5,849	$20,976
Hungary	10	$8,422	$19,754

LATAM	Population (million)	1992 GDP Per Capita	2012 GDP Per Capita
Mexico	115	$8,109	$15,300
Colombia	47	$4,682	$10,728
Chile	17	$6,150	$18,354
Brazil	197	$5,530	$12,038
Argentina	41	$7,100	$18,205

ASIA	Population (million)	1992 GDP Per Capita	2012 GDP Per Capita
China	1,353	$1,027	$9,146
India	1,223	$959	$3,851
Indonesia	244	$1,802	$4,957

Source: IMF statistics, October 2012. Gross domestic product based on purchasing power parity (PPP) per capita GDP, current international dollar. For illustrative purposes. We are not soliciting or recommending any action based on this material.

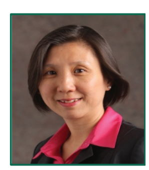
the same in most emerging markets, but each region has some that are more pressing than others. In Latin America, the key risk is inflation. In most of the countries in Latin America, inflation has been relatively benign. However, there have been exceptions, with Argentina being the most extreme and Brazil being the most concerning. At the moment, inflation in Brazil is running at the top over their band, 6.3% last count. This is something that can affect a consumer's willingness to spend, particularly on things that have a longer shelf life, or durable goods. But, the other countries in the region are not heading against that inflation headwind, which is important to remember. Consumers still recall the days of hyperinflation, boom and bust cycles, and that is what consumers, especially the older consumers, still have in mind when they look at changes in macroeconomic policy.

Some of the other limitations to the consumer story are limited credit, or on the flip side, excess consumer credit. Using Brazil as an example again, last year, the government had to enact some macro prudential measures to slow down lending for automobile consumption. Some banks were lending at terms that made no sense for used cars, such as 10 year loan terms for cars that do not generally last that long. Unfortunately, these pockets of lending surged ahead of themselves and subsequently had to be restrained.

The housing market in Chile at the moment is another case in point, as it experiences a huge urbanization boom. The central bank insists that there is no housing bubble. However, it is a little concerned about working capital at the construction companies themselves. With this in mind, we should remain prudent about housing markets in these countries.

Another difficulty, particularly in Latin America, is bottlenecks in infrastructure, especially bottlenecks that frustrate distribution (i.e., getting goods from warehouses and out to stores). In Colombia, the government announced a COP 14 billion transport program to connect cities that were cut off by the FARC guerrillas when they were very active in between the big cities. However, because of the lack of institutional strength, there is a shortage of people trained to get bid documents out, which means that the projects have not been able to go out for bids.

Q. How do investors convert the consumer growth story into investment opportunities, and what sectors offer the best opportunities?



Elizabeth Soon
Managing Director, Head of Small Cap Asia ex-Japan
Hong Kong

A. When reviewing sectors, it is easy to look at trends, but turning trends into opportunities is more difficult.

In Asia, while the Chinese consumer is increasingly important, you can separate the rest of the region into two categories. The first is the more developed ASEAN countries. The second is those countries that are still emerging, which is where

China and India fit. Within the ASEAN countries, we are seeing that consumers are more sophisticated in terms of their purchases. Therefore, we believe investors should look more at imported goods and the logistics companies that aid in their import.

Another area of interest is companies that are synonymous with their region, such as canning companies in Malaysia. These types of companies are entrenched in their businesses and enjoy a high market share. We are finding that this helps these companies easily extend their reach into places like Vietnam and other growth markets. Vietnam, for example, is a pretty closed market in terms of investments, but can be accessed through a company that is able to operate in it, which is how we are playing Vietnam through the ASEAN market.

Companies that are at the forefront of technology are also of interest. The next three to four years looks stagnant for smartphone development, which has been a driver of growth over the past few years. With this in mind, we will focus more on companies developing the best components for smartphones. These range from acoustic manufacturers to camera lens module players that can maintain market share, as their technology is state of the art. We play these trends in places like Korea and Taiwan, where we believe we will find the greatest opportunity in terms of sustainable growth and market share.

Finally, another key driver is the rise of the Chinese entrepreneur and their demand for luxury goods. The luxury end of the market is growing quite dramatically. Despite, the Chinese government clamping down on corruption, whereby Chinese officials are not allowed to buy extravagant things or be openly lavish, we believe the long-term trend is still very good. The producers of branded goods and passenger vehicles are growing significantly. For example, ultra luxury car brand Bentley is selling really well in China.

In fact, the only reason that you don't see the growth numbers is because they cannot produce enough to meet the demand. So that's why you don't see the growth numbers in actual terms.

Catrin Haden
Vice President, Head of Emerging Europe Equities
Stockholm

A. In our region, the housing sector is very positive. This is mainly due to urbanization and migration to larger cities. In both Russia and Turkey, we are seeing governments plan on how they can redevelop the infrastructure to accommodate demand growth. In Istanbul, they are even planning to relocate the airport in a couple of years' time. So, we are seeing a push from the government in the terms in redeveloping our cities. This leads to mortgages, which are still underdeveloped in our region. In Turkey, interest rates are already coming down. This factor is going to help the financing and affordability for people to buy houses. In Russia, we have not really seen interest rates come down but believe that is a possibility for the future.

The financial services sector is fairly positive, though it does vary from country to country. Credit card penetration is fairly high in Turkey and growing, and Russia is going to be a big market for many years to come. Insurance, pensions, pension planning, etc. are also likely to be a growth areas in Turkey, where the government is changing the rules for pensions. In Russia, the domestic pensions market has yet to develop. In Poland, there has been an increase in financial services companies, debt collection companies and mortgage brokers.

In post-communist Russia, retail chains are starting to develop, but consumers still prefer to buy from familiar outlets that they feel guarantee price and quality of their product. We are seeing not only more domestic producers but more international companies entering Russia and Turkey. As a stock investor, this is always both good and bad news, because it means more competition for domestic manufacturers.

Transportation, airlines, airport operators and catering services are also of interest as we are seeing more people travel and fly more, both domestically and internationally. Turkey is especially of interest, due to its geographical location, with close proximity to Europe and Africa.

As food consumption patterns change globally and we eat more protein, the role of companies that produce fertilizers becomes more important; subsequently, our exposure to these companies will grow.

STACY STEIMEL
Managing Director, Head of Latin America Equities
Santiago

A. One thing you have to be very careful about in Latin America consumer stories is the valuations across the sector. They can get stretched, particularly in the consumer staples space. Our multiples even broke through some of the Asian multiples, which were the highest before that happened.

There is a proliferation of stories to choose from; in Latin America, we prefer the pure consumer space, footwear and casual dining. As income levels rise, the propensity to spend on footwear rises faster than all other product categories.

Casual dining is another story that goes along with the maturation of the economies and is not interest rate sensitive, as payment is normally on a cash basis. Some households are depending more on prepared foods and dine out more frequently. The casual dining concept in airports and on roadsides is also of interest to us at the moment. Travel is an important driver, especially with the World Cup coming to the region. People are also switching from buses to air travel.

Agribusiness is the world's breadbasket in Latin America, both in the grains area, where there is a super harvest going on this year in Latin America, and also in proteins, particularly beef. Rising incomes translate into a move up on the protein chain of consumption, which has taken place all over the world.

Pharmaceutical and personal care manufacturers are also key. I think Russia and Brazil are the two countries with the highest spending on personal care, creating some really unique opportunities in those markets with key players.

So you can see that the consumer theme in Latin America is broad and diverse, and we believe it really does have an excellent and promising future.

Conclusion

Although each region faces challenges in terms of being able to sustain consumer growth, whether this is due to age, urbanization or the threat of information. We believe the potential of the consumer within the emerging markets in undeniable ■

Biographies

STACY STEIMEL
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PineBridge Investments, Santiago

Ms. Steimel joined PineBridge in 1998 and is responsible for managing the investment activities of Latin American equity portfolios. Her previous experience includes business development in a local investment bank, IM Trust, and three years as assistant to the US executive director of the Inter-American Development Bank, in addition to nine year's experience in international finance for the US Treasury Department. Her postings included key positions in the Group of Seven in Washington, DC and in the Embassy in London. She also served as a legislative assistant in the US Senate and House of Representatives. Ms. Steimel received a BA from the College of William and Mary, an MA in Latin American Economics from the University of Texas at Austin and an MBA from the Catholic University of Chile.

ELIZABETH SOON, CFA
Managing Director, Portfolio Manager, Head of Small Cap Asia ex-Japan Equities
PineBridge Investments, Hong Kong

Ms. Soon joined the firm in 2008, having extensive experience in managing investment teams and running Asia equity portfolios. She was director and head of the Pacific Basin for Standard Life Investments (Asia) Ltd., where she was responsible for the management of the group's Asian funds and a member of the Global Stock and Sector Insights Committee (UK). Ms. Soon also spent 10 years at Schroder Investment Management (HK), where she was director and head of Asia ex-Japan, responsible for asset allocation and stock selection in Asia, and managing retail unit trusts and large institutional portfolios. At Schroders, she was a member of the Global Asset Allocation Committee. Her investment experience began at a predecessor firm of Allianz Global Investors, as portfolio manager and market specialist focused on Malaysia, Singapore, Indonesia and Taiwan. Ms. Soon holds an MBA from Manchester Business School, UK and a Bachelor of Accountancy from the National University of Singapore. She is also a CFA charterholder and a board director of the Hong Kong Society of Financial Analysts.

CATRIN HADEN
Vice President, Portfolio Manager, Head of Emerging Europe Equities
PineBridge Investments, Stockholm

Mrs. Haden joined the firm in January 2011 and is responsible for managing emerging europe equity client portfolios. Prior to joining PineBridge, Mrs. Haden spent five years as a senior private banker/investment manager for Ultra High Net Worth individuals. She started investing in emerging Europe in 1996 while at SEB Investment Management in Stockholm and London, when SEB launched its Eastern European Funds. Mrs. Haden also worked at the London and New York offices of PineBridge's predecessor firm, AIG investments, where she spent time managing the same emerging Europe and global emerging markets portfolios that she returns to today. She has an MSc. in Economics and Business Administration from the Stockholm School of Economics, holds the Swedsec license and is IMC qualified.

The full audio replay is available upon request from your PineBridge representative, or email us at **info@pinebridge.com** or visit **www.pinebridge.com**.

May 2013