



# The Great Confluence

SOMETHING BIG IS HAPPENING IN EMERGING MARKETS

Kevin T. Carter | March 18, 2015

## Where the Growth Is

Any investment professional that has spent even a small amount of time studying Emerging Markets knows that the key growth story in the developing world is the growth of the consumer class. There are dozens of studies and reports published by investment banks, consulting firms and fund companies showing us how literally billions of humans are moving from subsistence income levels to levels where they begin to consume more and better food, clothing, appliances, cars, etc. It's a very good story. It's a big story. In a report titled "Going for Gold in Emerging Markets" McKinsey & Co concludes:

**“By 2025, annual consumption in emerging markets will reach \$30 trillion—the biggest growth opportunity in the history of capitalism.”**

That is a bold statement. Not a “large opportunity” or “good opportunity” but the *biggest* growth opportunity in the history of capitalism. And while it may sound like hyperbole, based on my personal research, analysis, travels, experience and logic I think it's true. Besides, even if it turns out to be only the 2<sup>nd</sup> or 3<sup>rd</sup> best opportunity in the history of capitalism it might be worth a closer look.

## What did the Alibaba IPO Mean?

The IPO of Chinese Ecommerce giant Alibaba is fading in the memory of the investment community. Though, with all the hype coverage, it is more like the haze of a mild concussion. I liked the assessment from popular financial pundit Josh Brown who wrote on “Alibaba day”:

**“The truth is, today is a historic moment. It's one of the largest IPOs in history – you've seen all the stats and superlatives I'm sure. But we won't know just what it all means for weeks, months or years to come. The significance of this day will not be fully realized anytime soon – like most major market events. Sure, we can speculate.”**

He was right. It was, after all, the largest IPO ever on the NYSE. It was a big deal. But what *did* it mean?

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I suggest that what the Alibaba IPO “means” is that several powerful trends are coming together in a great confluence with staggering results. Just as the massive population wave in emerging markets is joining the consumer class, the tools, methods and models of consumption are undergoing a once in a lifetime transformation as three other major trends take hold.

### Trend 1 - Smartphones Are Becoming Ubiquitous and Affordable

When did you first have a phone with a touch screen? For me the answer is 2009, just a few years ago. And yet, now, the idea of not having one, seems implausible. What would I do? Indeed, The Economist has recently labeled the smartphone “the defining technology of the age” adding a prediction that 80% of all adults “will have a supercomputer in their pocket” by 2020.

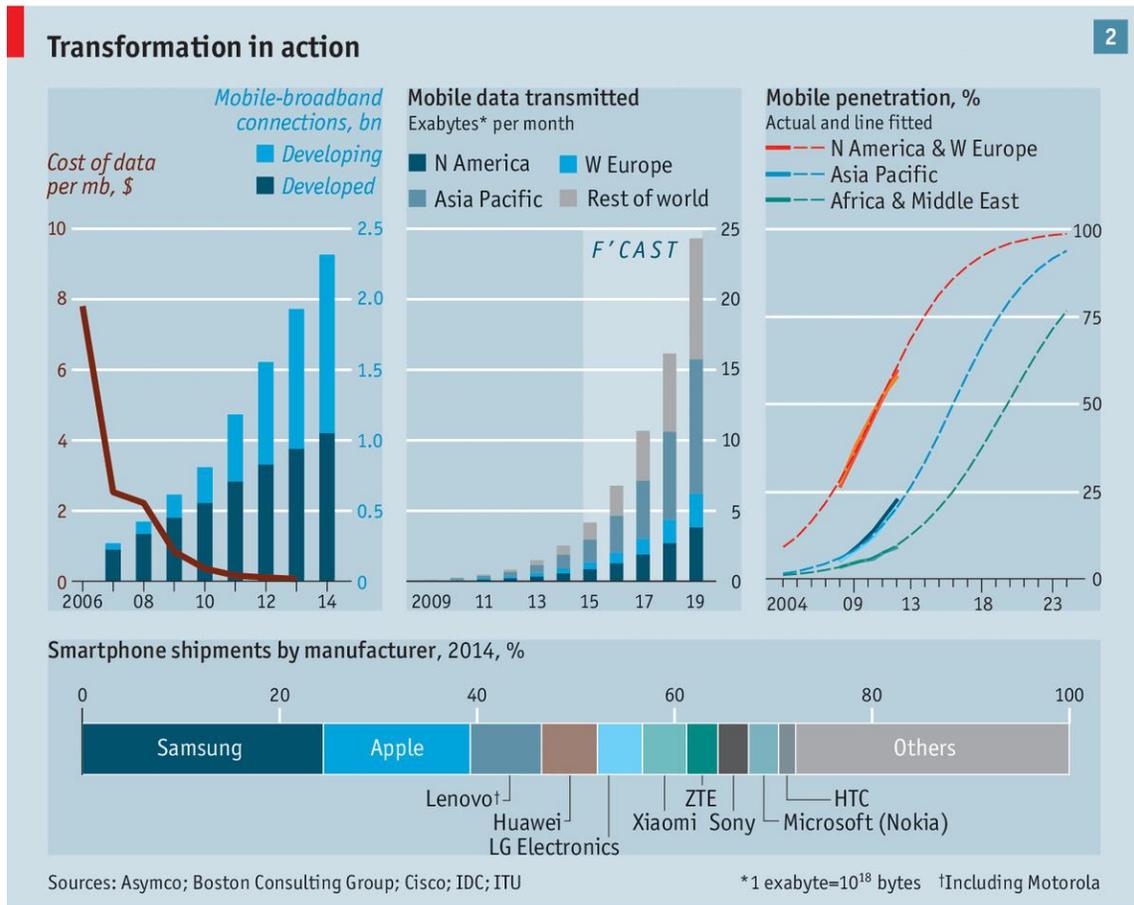


Economist.com

Fueling the spread of this technology are new competitors that are driving down prices for entry level smartphones making them affordable for more people. Chinese smartphone maker Xiaomi – started less than 5 years ago - sold over 60 million units in 2014 and may sell 100 million in 2015. Xiaomi is now the world’s most valuable private company. In India, market leader MicroMax is selling smartphones for under \$40. And, it may still be the first inning of this game. Consider for example that India has 1.25 billion people and only 150 million smartphones today.

## Trend 2 - Mobile and Wifi Broadband Internet Access are Surging

When was the first time you were able to reliably watch a video on your phone? The answer for me is only in the past couple of years. I live 50 miles from Apple headquarters and am generally slightly ahead of the U.S. curve in adopting consumer technology. It seems to me that if I am just getting these things, most of the people in the developing world must not have them quite yet. Indeed, the chart below indicates that this is true, and that the spread of mobile broadband is in the early stages but surging quickly.



Economist.com

## Trend 3 - The Globalization of the Capital Formation Process

Across the developing world, local entrepreneurs are partnering with U.S. venture capital investors to pour their hearts, sweat and billions of dollars from U.S. institutional investors into ecommerce startups. In many cases – like Alibaba – these enterprises are enjoying tremendous success and creating significant value. And while Chinese companies have received the majority of the funding and attention thus far, the trend is spreading.

India, with its massive population and low penetration rates is the current hot spot for venture investors. But it's happening everywhere from Vietnam to Colombia to Turkey. It's even happening in Africa, which has been an economic and investment basket case for my entire lifetime.

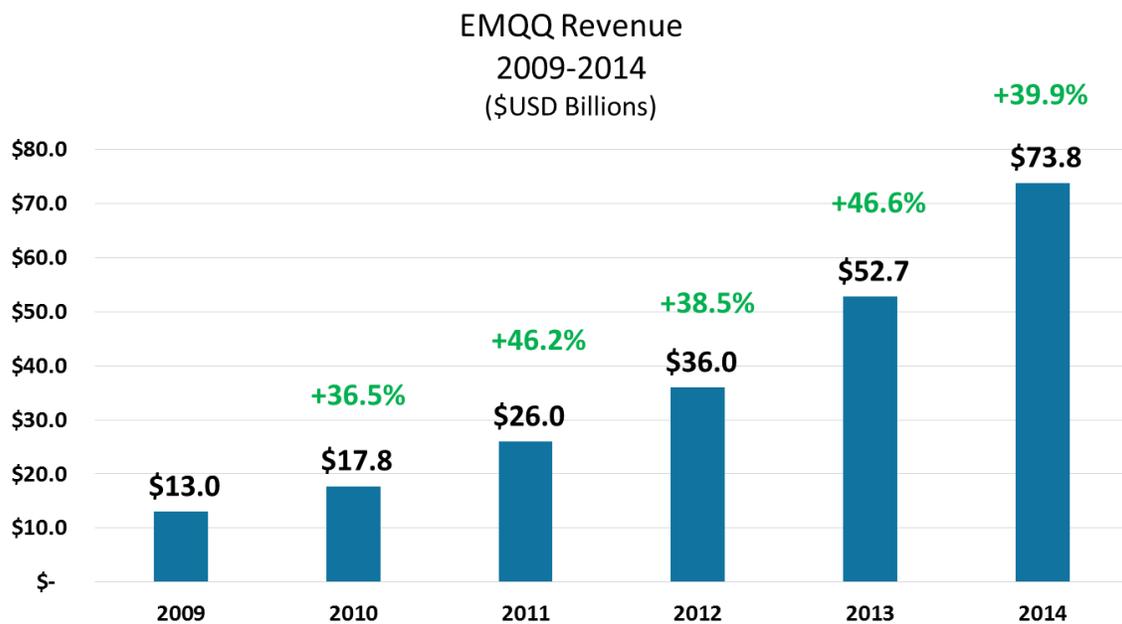
The most successful of these companies will likely continue to IPO – like Alibaba – on U.S. stock exchanges. For investors, this is important to note because if they are listed on the NYSE or NASDAQ these companies are left out of most Emerging Market ETFs for, frankly, dumb technical reasons.

### Results of the Great Confluence

Investors in Emerging Markets should make note of the following things that are happening as a result of The Great Confluence.

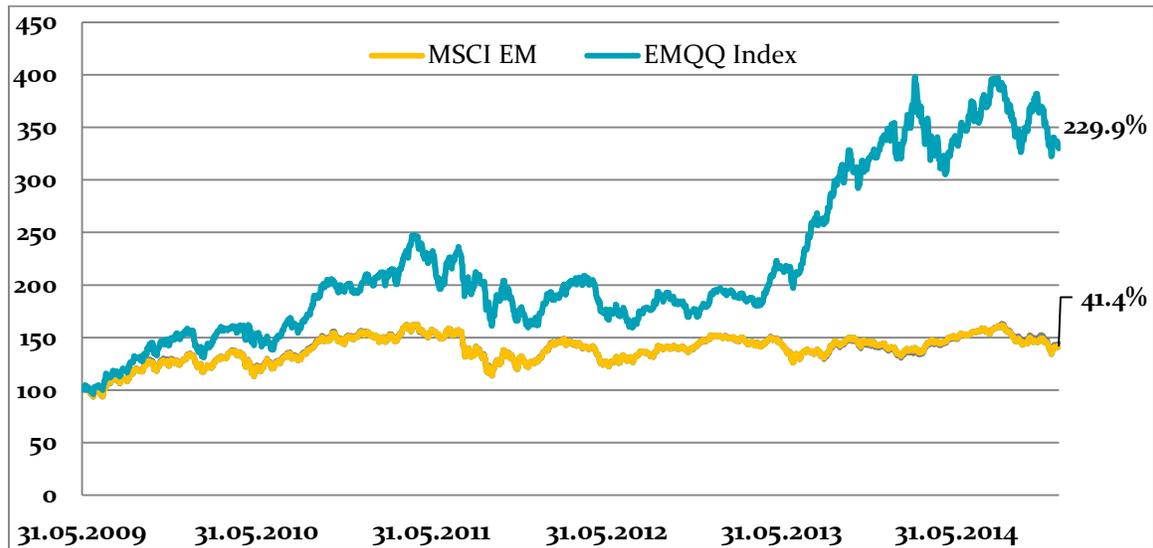
#### Result 1 - Serious Revenue Growth

The Chart below details the annual revenue and growth rate of all publicly traded Emerging Markets internet and ecommerce companies as defined by EMQQ The Emerging Markets Internet & Ecommerce Index.



## Result 2 – Significant Value Creation

The growth in revenue has led to similar growth in the value of publicly traded Emerging Markets ecommerce companies. The chart below details the returns of the EMQQ Index from June 1, 2009 to December 31, 2014.



## Result 3 – Emerging Markets ETFs are NOT Participating in This Growth

Recently many investors have lamented the poor performance of Emerging Markets – especially relative to the U.S. market. In fact, as I write this on March 13, 2015 the Barron’s Emerging Markets Daily column begins with “*Growth is missing from the emerging market story, and that makes EM assets unloved.*” There is growth in Emerging Markets, and it’s significant, but it’s largely left out of the indexes and the ETFs that track them. In fact, only two of the forty four companies in the EMQQ Index are included in the largest Emerging Markets ETF (NYSE: VWO).

## The Great Confluence is Just Getting Started

By now most of you have heard of Alibaba founder Jack Ma. But have you heard of Sachin and Binny Bansal? They are the founders of FlipKart – “the Alibaba of India”. They raised nearly \$2 billion in venture capital last year from investors including the family office of Mark Zuckerberg. FlipKart will likely file for an IPO on a U.S. exchange sometime in the next year and you will hear about it. (Remember, you heard it here first.) How about Sim Shagaya? Ever heard of him? Don’t worry, you will.