



# The Great Confluence

SOMETHING BIG IS HAPPENING IN EMERGING MARKETS

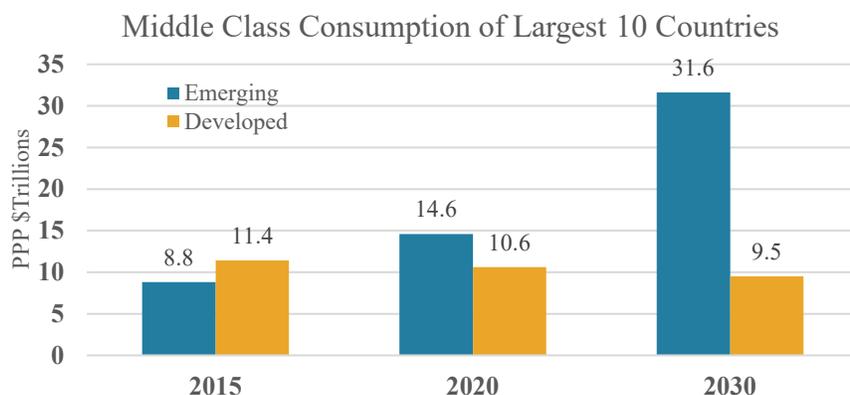
Kevin T. Carter | May 17, 2018

## 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 emergence of the middle class consumer. There are numerous studies published by investment banks, consulting firms and fund companies showing us how literally billions of people in developing countries are just now entering the middle class and increasing their discretionary consumption seeking out more and better food, clothing, appliances, cars, educations etc.. It's a big story that is fundamentally changing economies across the globe and in rapid time. 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 hyperbolic, 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.



Global Middle Class Consumption PPP \$Trillions and % Global Share

### Top 10 Countries

Country	2015	Share (%)	Country	2020	Share (%)	Country	2030	Share (%)
U.S.	4.7	13	China	6.8	16	China	14.3	22
China	4.2	12	U.S.	4.7	11	India	10.7	17
Japan	2.1	6	India	3.7	9	U.S.	4.7	7
India	1.9	5	Japan	2.1	5	Indonesia	2.4	4
Russia	1.5	4	Russia	1.6	4	Japan	2.1	3
Germany	1.5	4	Germany	1.5	4	Russia	1.6	3
Brazil	1.2	3	Indonesia	1.3	3	Germany	1.5	2
U.K.	1.1	3	Brazil	1.2	3	Mexico	1.3	2
France	1.1	3	U.K.	1.2	3	Brazil	1.3	2
Italy	0.9	3	France	1.1	3	U.K.	1.2	2

Source: Global Economy and Development, Brookings Research  
Data for 2020 and 2030 is projected and not guaranteed.

## 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.”**

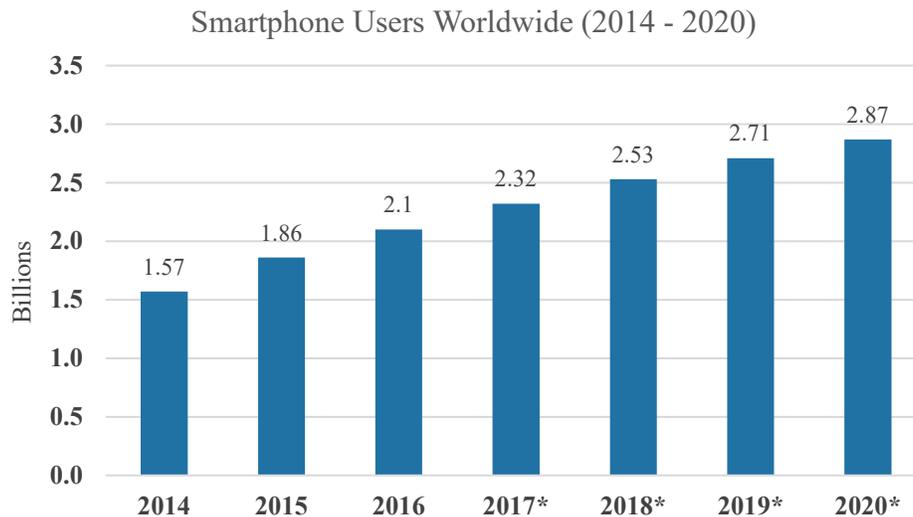
He was right. It was, after all, the largest IPO ever on the NYSE. It was a big deal. But what *did* it mean?

## The Great Confluence

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 Affordable and Ubiquitous

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.



Source: Statista

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 10 years ago - sold over 60 million units in 2014 and may sell 100 million in 2018. 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 1/3 of the population are smart phone users, according to eMarketer.

### Disclosure

Data for 2017-2020 is forecasted.

There is no assurance or certainty that the outlook or forecasts will come to pass.

## 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.

**Smartphone Penetration by Country (2017)**

Country	Smartphone Users (MM)	Smartphone Penetration	Total Population
United States	226	70%	326,474,000
Germany	55	69%	80,636,000
United Kingdom	44	69%	65,511,000
Russia	78	55%	143,375,000
China	717	52%	1,388,233,000
Japan	63	50%	126,045,000
Mexico	52	41%	130,223,000
Brazil	79	38%	211,243,000
India	300	22%	1,342,513,000
Indonesia	54	21%	263,510,000

Source: IMF, World Economic Outlook Database

## 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 investment basket case for my entire lifetime.

### **Most Emerging Markets Ecommerce Companies are NOT in major ETFs**

The Alibaba IPO in September 2014 raised awareness of a little-known fact about emerging markets ETFs – namely, that U.S. listed Emerging Market companies like Alibaba (NYSE: BABA) were not included in major indexes and ETFs. As even the USA Today reported:

**“The fact that they're saying it won't be in many indices, or broadly followed indices, it raises the question of what indices are supposed to do.”**

The reason most of these companies IPO in the U.S. is because they are backed by U.S. institutional venture capital. The reason these companies are not included in the ETFs are technical. In short, it has to do with the legacy nature of the major index providers and the globalization of venture capital discussed above. Perhaps Tom Lydon of ETF Trends said it best:

**“It's the clash of the old world legacy index companies with the fast pace of IPOs and ETFs today”**

This issue has only recently been fixed. MSCI added Alibaba and similar companies to their indices over one year later in late 2015 and in two phases lasting into 2016. FTSE only recently added these companies in late 2017. Investors in funds based on these indices missed out on the strong performance of Alibaba during these time periods. This highlights the potential issues that rules-based indices may encounter in reacting to the increasingly global and complex world of finance.

### **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 over \$7 billion in funding rounds since the company's founding in 2007. Wal-Mart recently announced that they will acquire a 75% stake in the company. We first told you about this company in our initial paper in 2015 and told you that you would be hearing about it. How about Sim Shagaya and Konga.com? Ever heard of them? Don't worry, you likely will.

## About the Author



Kevin T. Carter is the Managing Partner of Big Tree Capital and Founder of EMQQ The Emerging Markets Internet & Ecommerce ETF (NYSE: EMQQ). Since 1999, Mr. Carter has worked with Princeton Economist Dr. Burton G. Malkiel in the development of both passive and active index-based strategies. Previously he was:

Founder, Chairman & CEO of AlphaShares, an investment firm that offers five Emerging Markets focused Exchange Traded Funds (“ETFs”) in partnership with Guggenheim Investments. These funds trade on the New York Stock Exchange under the tickers YAO, HAO, TAO, CQQQ & EMRE.

Founder, Chairman & CEO of Active Index Advisors (“AIA”), an investment management firm specializing in index and ETF based investment strategies. AIA was acquired by Natixis Asset Management in December 2004. The AIA *Active S&P 500* strategy has outperformed the S&P 500 on an after tax basis by over 3.0% annually net of fees since inception in 2002.

Founder, Chairman & CEO of Electronic Investing Corporation (“eInvesting”). eInvesting was an online broker that allowed investors to trade stocks in dollar amounts instead of share amounts thus allowing for diversification of smaller portfolios. Mr. Carter led eInvesting from inception through its July 2000 acquisition by E\*TRADE Group.

Mr. Carter received a BA in Economics from the University of Arizona and began his career with the investment management division of Robertson Stephens & Company in San Francisco in 1992.

## Disclosure

International investments may involve risk of capital loss from unfavorable fluctuations in currency values, from differences in generally accepted accounting principles, or from economic or political instability in other nations. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. Frontier markets generally have less developed capital markets than traditional emerging market countries, and, consequently, the risks of investing in foreign securities are magnified in such countries. These countries are subject to potentially significant political, social and economic instability.