

# west to east – harnessing the investment opportunity

March 2010

**Graham French** explains how he plans to benefit from the shift in economic power from West to East.



As government deficits continue to soar, the economic environment in the Western world remains deeply uncertain. Worries about sovereign debt risk have intensified, and many investors are concerned about the impact of public sector austerity measures on the health of economies and companies.

But this uncertainty is primarily a Western phenomenon. The continued strength of the faster-growing parts of the economic world provides, I believe, good reason for long-term optimism on the part of investors.

## shift in economic power

A fundamental shift of economic power has been under way for some years now, from the developed West to the developing East. China and India are at the forefront of a multi-decade transformation, with investment in infrastructure projects such as roads, hospitals and housing generating strong demand for commodities.

Spending on public works is creating jobs and putting money into people's pockets, and the subsequent step-up in household income is producing an increasingly affluent middle class who are spending more to improve their quality of life.

Companies that understand this shift and are positioned accordingly, whether they are platinum producers or toothpaste manufacturers, will continue to benefit strongly over the coming years.

## right side of the 'growth gulf'

I have long emphasised the importance of being on the right side of the growth gulf between East and West. Whilst there has

been much talk of a 'lost decade' for equity investors, for those in companies that have recognised the shifting dynamics of the global economy, and hence have been well-positioned to provide industrialising economies with much-needed materials, goods and services, the last decade has been phenomenally profitable. The success of companies with unique resources, assets and brands, such as BHP Billiton, P&O and Colgate-Palmolive, bears testament to this.

In contrast, for many investors anchored in the UK and the US holding companies that have struggled to compete, the past ten years have seen a marked erosion of value. This has been starkly illustrated by the decline of industries such as European steel manufacturing and the US auto makers.

favourable overall demand and supply dynamics for many years to come.

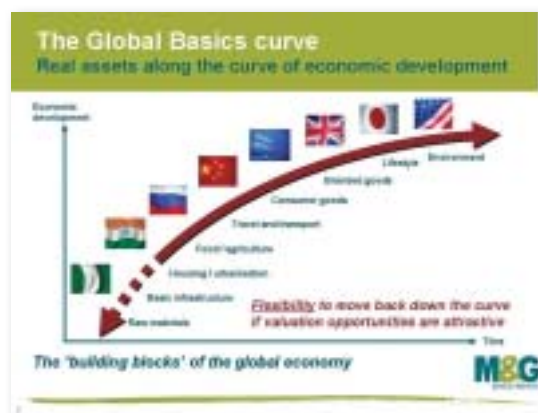
## 'indirect' investment

While I retain full confidence in the ongoing shift in economic power from West to East, this does not mean investors should necessarily invest directly in Chinese or Indian stocks. Company valuations can be over-inflated by excessive expectations for future growth. Also, and importantly, many companies in these markets are simply not sufficiently shareholder-focused, with corporate governance standards often below the standards investors should require.

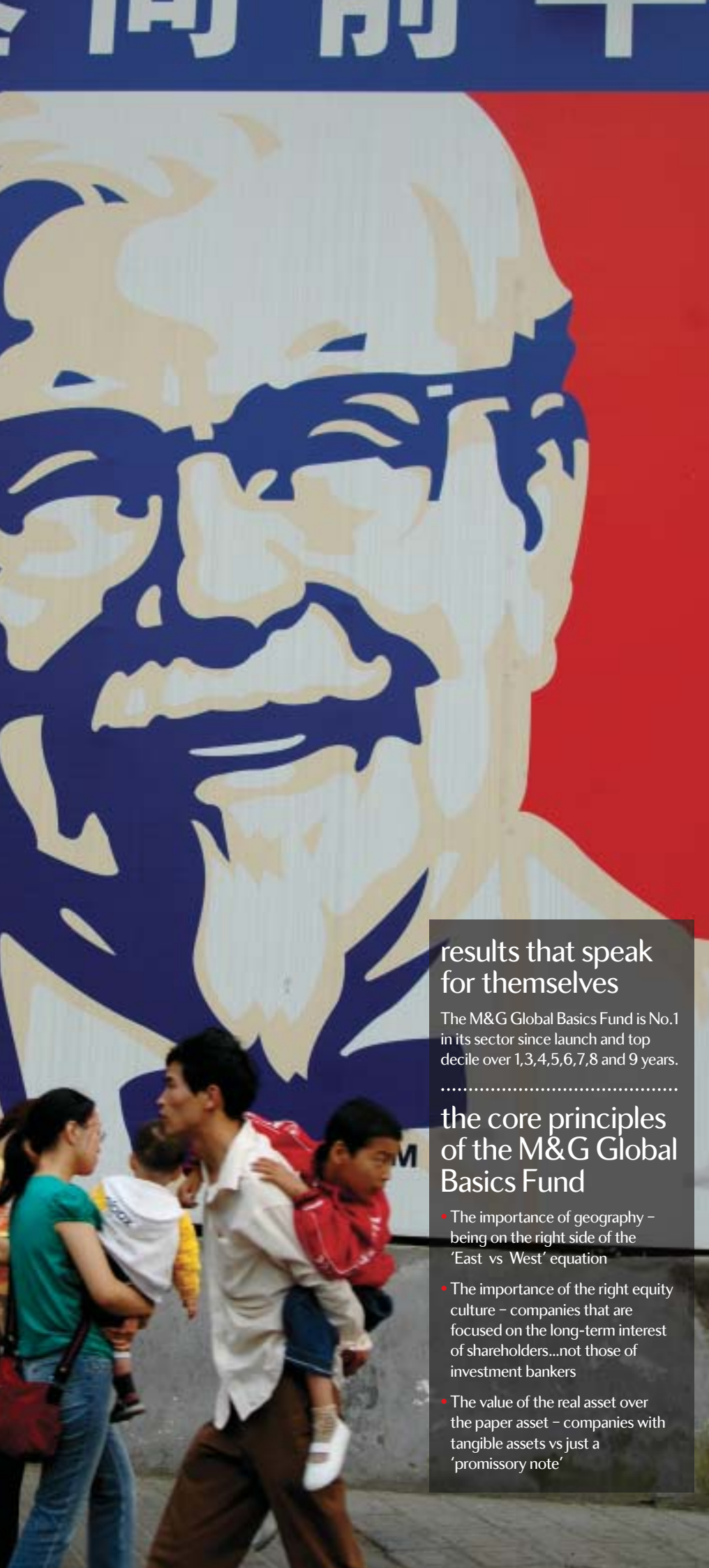
My preference is therefore for a conservative approach, mainly holding global companies listed in the West that operate in the emerging regions. I look to pick companies that have geographically -diversified revenue streams from well-established, developed markets, as well as from faster-growing emerging markets; companies such as Aggreko, Yum! Brands, PZ Cussons and Unilever, which are well-positioned in many parts of Asia, Latin America and Africa.

Valuations for these companies can be cheaper than average because the market often overlooks their exposure to faster-growing markets and continues to perceive them as 'boring', Western, slow-growth businesses.

We are also keeping a close eye on a number of locally-listed emerging market companies, for example in India, which will, I believe, represent good long-term opportunities. >>



Given the strong rally of last year the valuations of some commodities-related companies are now prompting a degree of caution, and we have taken profits in selected holdings. But the long-term commodities-intensive economic growth of many developing countries still points to



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*Yum are the world's largest restaurant company with franchises including KFC, Pizza Hut and Taco Bell, with huge growth in Asian markets.*

>> For the time being, however, I remain cautious about such investments.

It is also important to focus on companies that are committed to the right equity culture – those that concentrate on superior long-term returns for shareholders rather than targeting growth for its own sake. Fast-growing companies are not necessarily good investments.

At M&G, we see an ongoing battle between long-term ownership of companies and short-term trading. We believe strongly that the primary purpose of stock markets is to provide capital for well-managed companies to produce the goods and services that the world needs. Those are the companies that I seek for the M&G Global Basics Fund. ●

*Graham French manages the M&G Global Basics Fund.*

### results that speak for themselves

The M&G Global Basics Fund is No.1 in its sector since launch and top decile over 1,3,4,5,6,7,8 and 9 years.

### the core principles of the M&G Global Basics Fund

- The importance of geography – being on the right side of the 'East vs West' equation
- The importance of the right equity culture – companies that are focused on the long-term interest of shareholders...not those of investment bankers
- The value of the real asset over the paper asset – companies with tangible assets vs just a 'promissory note'

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The Skandia Life fund will not mirror the performance of the underlying fund because of Skandia fund charges, taxation adjustments (if appropriate) and the Skandia investment process. Past performance is not a guide to future performance.

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