



# STUART + CARLYON

Financial advisers for your lifetime goals

## Emerging nations – and submerging nations

Both Deborah and Susanna attended the annual Portfolio Construction Forum, a major professional conference in Sydney which delivered several provocative sessions.

One keynote was by Jonathan Pain, financial commentator and author of The Pain Report. He rather neatly summed up two types of nations to watch in the world economy. The difference is not geography he said, but debt.

On the one hand there are those burdened by debt – the so called submerging nations including Iceland, Greece, Spain, UK, USA and Dubai. These will have years of fiscal austerity and consumer frugality and low GDP growth rates. By contrast the cash-rich emerging nations including Brazil, India, Indonesia, China, and Vietnam will fuel the world economy.

In this sense we can be glad that the global economy is so intertwined and that the emerging nations will help the submerging nations from going under completely.

In part this is because they are buying more. Three billion consumers in Emerging Asia can now afford discretionary consumer goods and Pain's figures were dazzling. In 2002 in India there were 6 million mobile phone subscribers and now there are 600 million subscribers and 20 million mobile phones sold, per month.



### China is key – is it stable?

The question global economists are asking is: will the burgeoning Chinese economy suffer a big correction? Two economists at the conference, Manu Bhaskaran based in Singapore and Woody Brock in the US, outlined several sources of risk in China including:

#### 1. Internal political security

- Widespread corruption, abuse of power, unclear property rights.

- Rising inequality, urban-rural divide.
- Tension between central and local governments.

China is not easy to govern but the ruling party is showing efforts to adapt; diverse views are more tolerated.

#### 2. Economic and financial bust

- There appear to be various Bubbles about to burst including garlic prices, copper speculation, real estate. The economy is prone to speculative forces.

Bhaskaran noted that despite the rampant speculative pressures the Chinese central government managed the events around the Global Financial Crisis quite adroitly. Overall, they say, China has more shock absorbers (policy, economic momentum, reserves) than shock amplifiers (financial system.)

#### 3. Geopolitical threat. China has a patient but insistent policy of expansion. But could it reach some flashpoint?

- China is asserting more economic if not military influence into the South China Sea.
- It has huge vested interests globally, for example oil partnerships and massive tracts of arable land in Africa.
- There is a potential for a clash of some kind with India. Both are growing rapidly, compete for resources and have fundamentally divergent world views.

### What China means to the West

The economy of China as the lead emerging nation is, of course, increasingly intertwined with the West. After decades of a somewhat arms length relationship via free trade, China's significance as a marketplace is not lost on the USA, Europe or Australasia. We need China for our balance of payments. One indicator of this is the fact that Germany now exports more to China than to neighbouring France. There's a waiting list for BMWs in Beijing.

### Back to the emerging and submerging idea

Submerging nations, the western nations that face steep debt problems, include the USA and much of Europe. Should governments be borrowing more to ignite growth? Yes, says Woody Brock. If US central government spending is focussed on bold infrastructure projects with high long-term payoffs, the economy will see efficiencies and growth. But think US bullet trains and rebuilding the electrical grid rather than traditional public works such as parks and museums.

And let's not forget that the US is a two speed economy, and for every struggling GM there is a booming Apple. Technology companies do good global business and have strong cash flows. The US is still the engine room of the technology and IT sectors.

## What it means for our clients

- Don't buy overpriced assets.
- Cash flow and income is very important – and will make up more and more of future returns.
- Buy into companies with solid dividends.
- Invest into the emerging countries via companies with strong brands selling into Asia.
- Expect volatility –it's the norm.
- Avoid Sovereign debt- not only due to low yield but deflation risk.
- Reduce personal debt (increasing savings).
- And for future students, learn Mandarin...a passport to the new reality.

## Personal view of China by Susanna Stuart

Some of our long standing clients may recall the slide show in 1995 of my journey to see my mother's village near Guangzhou China. That 'roots trip' was immensely rewarding, and a peek into a hitherto closed nation. Last month for my mother's 80th birthday my sister and I decided to return to China to visit family and to see the new China.

We divided our time between two families who live in South China – close to Hong Kong. My aunt and her husband live in Guangzhou (Canton) and my uncle and his wife live in Zhuhai. It was nice to see the changes through their eyes.

My family in Guangzhou still live in the central city apartment I saw in 1995 but their whole inner suburb is being remodelled furiously with re-paving and landscaping in time for the Asian Games. The once dirty Pearl River is now a beautiful feature of the city.

Being so close to Hong Kong, trade from the West has always favoured Guangzhou. Since my last visit, there's been a huge investment in infrastructure. Today it feels more like a modern metropolis with umpteen flyover roads, a new airport, a full underground system: though I still can't get over the bamboo scaffolding that is still prevalent.

My two cousins (a teacher and architect) are each married and have managed to buy apartments close to their parents. The family used to shop at fresh markets close by but these have now been replaced by huge supermarkets.

Although we didn't visit my mother's village birthplace, the family tells us it is surprisingly intact. The lychee orchard is still there and the city sprawl hasn't quite reached that far. Not yet anyway. I think a generation of city dwellers pine for the simplicity of rural life.

One day we went to one of the most talked about restaurants (and everybody in this city talks about food) a village style establishment on the city outskirts that serves fresh, organic, peasant food. It was very popular.

But China mostly looks forward, not back. The remarkable rise of China as an economic powerhouse is due to central planning and investment in business. Zhuhai where my uncle's family lives is one of the original Special Economic Zones set up in 1980. It is a garden seaside city and because of its location as a port close to Guangzhou and Hongkong it was designated as the hub for high-tech and heavy industries.

I say "Garden City" advisedly. The traffic is frightening in Zhuhai. Cars and trucks do not stop for pedestrians even if they are on the crossing. One day in a taxi, I asked the driver to slow down a little. "I can't!" yelled the driver, turning to us in the back seat. "I have to get you to your location and then on to the next ride. I need to make money!"

Money. Everywhere we met successful business people, some, like one clothing manufacturer, ignoring the west in order to focus on the real growth area: China itself. Even so, businesses like his are not immune from the global economy. One day we visited a five storey shopping centre devoted to home fittings, furniture and appliances. It was virtually empty of shoppers on the day.

This is still a Confucian culture. There is no great yearning by the average Chinese for democracy along Western lines – they are busily focused on making the most of today's economic growth. Even so, there is an eye on the future, and education remains highly valued.

I was amazed by the changes that have occurred in just 15 years. In 1995 I recall seeing shoppers visiting a department store and gazing longingly at appliances from the West. Now they make them for us, and with the money they earn the wealthy now select the best brands the world has to offer. I don't think I've ever seen so many BMWs and Mercedes (motorcycles are now banned in downtown Guangzhou). There's a reverse snobbery these days. Made in China is a label that is embraced everywhere now, except, it seems, in China itself.

