



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 2nd or 3rd 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.”

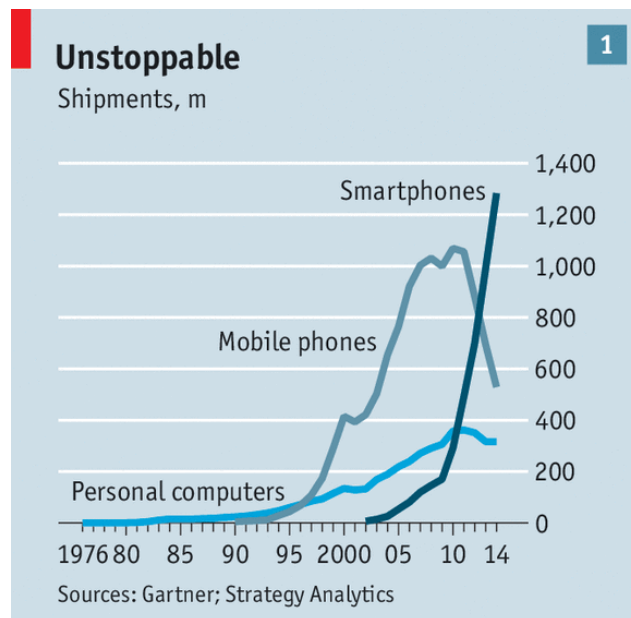
He was right. It was, after all, the largest IPO ever on the NYSE. It was a big deal. But what *did* it mean?

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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 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.



Economist.com

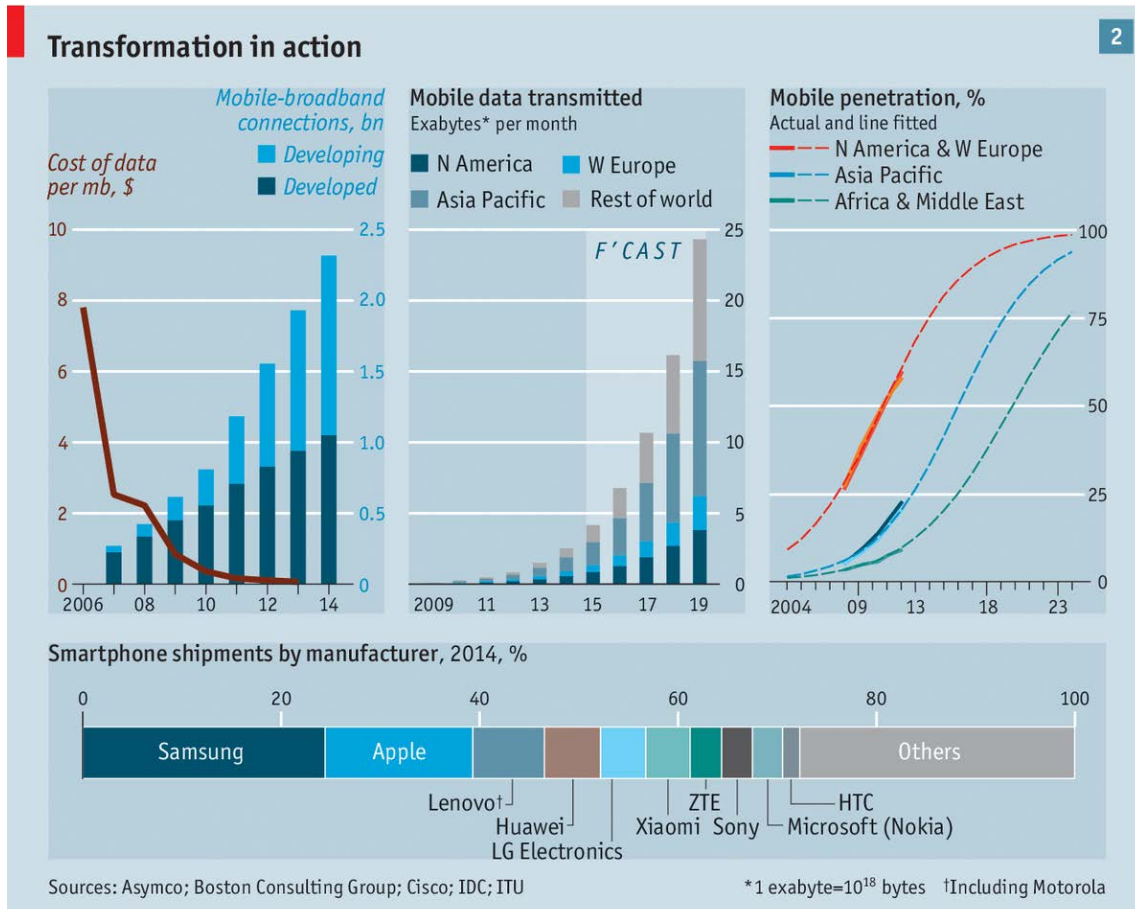
Fueling the spread of this technology are new competitors that are driving down prices for entry level smartphones making them affordable for more people. Chinese smartphone maker Xiaomi – started less than 5 years ago - sold over 60 million units in 2014 and may sell 100 million in 2015. Xiaomi is now 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.

Disclosure

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.



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 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) are 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”

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 and Konga.com? Ever heard of them? Don't worry, you 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.