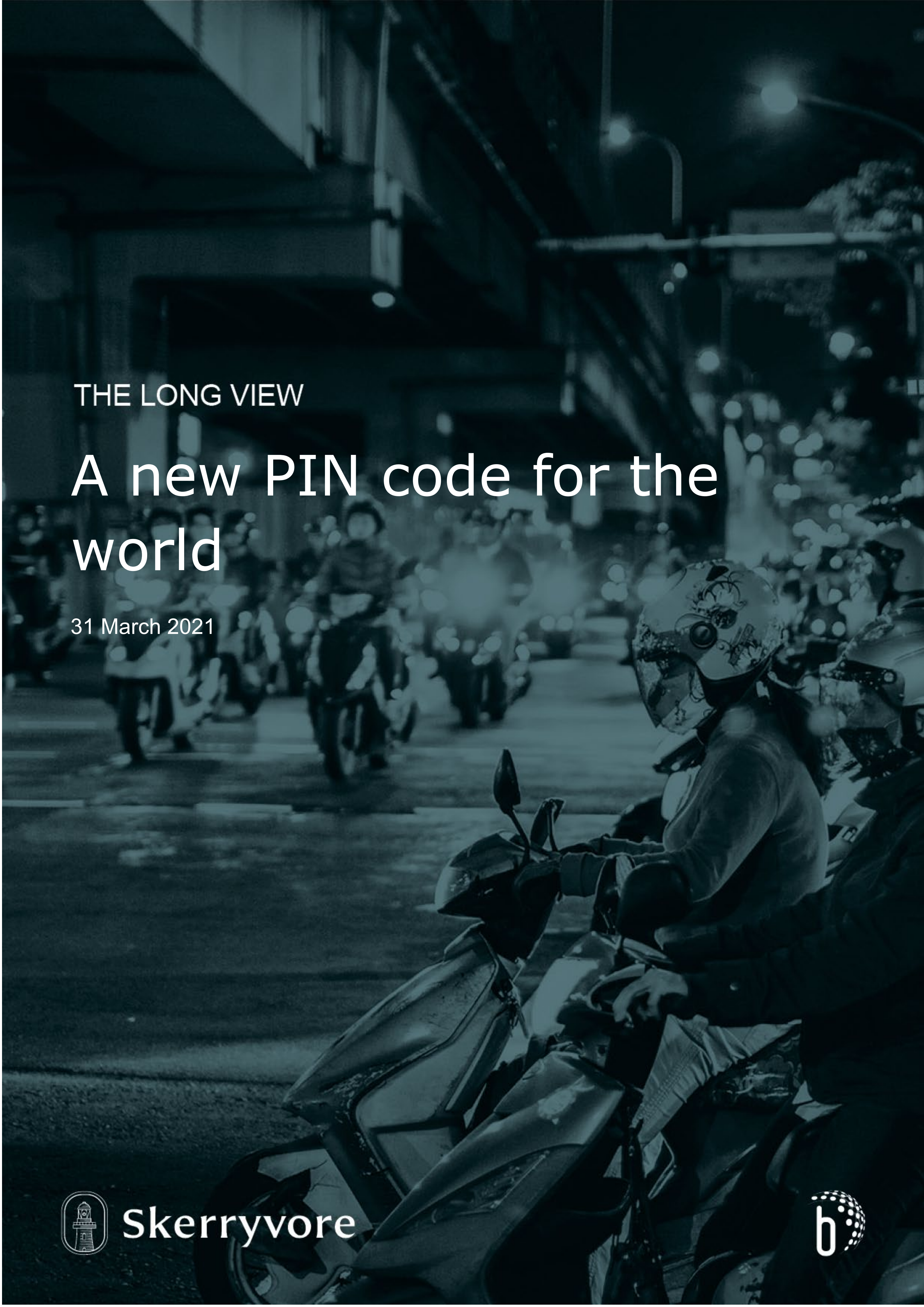

THE LONG VIEW

A new PIN code for the world

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Skerryvore

Changing global demographics can present opportunities for the careful investor.

In his fascinating and uplifting 2018 book Factfulness, Hans Rosling neatly summarised the dispersion of the world's population with 'The PIN Code of the World'. The current PIN code is '1-1-1-4', which stands for 1 billion people in each of the Americas, Europe and Africa, and 4 billion in Asia. Rosling projected that by the end of this century it will be 1-1-4-5, with more than 80% of the world's population living in Africa and Asia[1].

Today companies listed in emerging markets (EM) still comprise only about 13% of the investable global equity market in terms of market capitalisation, which has increased from 4% in 2002 and less than 1% in 1987. In aggregate, favourable demographics would therefore still appear to present a tailwind for investing in emerging markets.

The problem with painting all of EM with the same brush becomes apparent when looking at Asia. The difference between countries is stark. Those in the north tend to have falling fertility rates and aging populations, whereas those in the south are still experiencing significant increases in population.

As we look at our investment universe today, where does this demographic tailwind still hold true and, more importantly, where does it create attractive opportunities for the patient investor?

Parts of Asia have already "emerged"

Despite a GDP per capita on a par with that of the UK and a median age which has recently jumped above that of Switzerland, **South Korea** is still classified by some index providers as 'emerging'[2]. In an attempt to curb a falling fertility rate and declining population the government has recently taken steps to substantially increase cash allowances for expectant mothers and young children[3]. From an investment perspective, many categories tend to be quite mature, suggesting domestic volume growth may be harder to come by. However, some areas should still do well. Take for example beauty products, where an aging population appears to have had a positive effect on demand and brand loyalty. LG Household & Health Care looks well placed to continue to expand its luxury cosmetics brands both at home and in its overseas markets. LG's high-margin cosmetics business now accounts for over 75% of operating profit but despite this its shares trade at a considerable discount to global peers in the beauty industry.

China is another country facing an aging issue. Its population boom between 1950 and 1978 saw it double in size to 1 billion people, a 20% annualised growth rate. The one-child policy was enforced the year after and continued in various forms until its relaxation in 2015. In the five years since, younger generations have been slow to embrace their freedom to raise larger families and the birth rate continues to fall, suggesting the increasing costs of family accommodation and child rearing play a much bigger role in this decision[4]. There is also the problem of a gender imbalance from decades of male births, which hinders family formation. A comparison may be helpful here. Japan's problem with an aging population is well known: the over-65s went from 10% to 20% of the total population between 1984 and 2007. China is forecast to take only 20 years to reach the same outcome, possibly by as soon as 2037[5]. More resources will have to be spent on healthcare provision and social security to cater for an elderly society, putting further strain on state and local government coffers. Recent suggestions of increasing the mandatory retirement age, which has remained unchanged for four decades, have already been met with pushback from the younger generation[6]. Immigration may be one solution to boost the working-age cohort but would have to increase markedly from very low current levels of 0.1% of the population[7].

Increasing household expenditure presents opportunities

Although the population is aging, China's impressive technological advances will hopefully allow standards of living and household expenditure to continue to rise, meaning opportunities should still abound for companies to benefit from the 'premiumisation' of products and services. **Beer** is an interesting example of such a trend. Although China already accounts for 25% of the global beer market by volume, the share of premium brands is still relatively low, at 16% compared with 42% in the US, meaning there is still a large opportunity for consumers to trade up if income levels rise[8].

We believe China Resources Beer is poised to benefit from this, with its ability to draw from the international stable of Heineken brands. However, we are conscious that its current valuation is now discounting a substantial shift in its average selling price per unit and consequently have been trimming our position in recent months. We see a similar story for other Chinese companies on our watchlist. Stretched valuations suggest considerable premiumisation will need to occur for an investor to make an adequate level of return, and that is before you discount the possibility the anointed leaders do not remain as such.

Elsewhere, population growth holds potential

In contrast to North Asia, which countries would one still expect to benefit from strong volume-led growth over the years ahead? According to the UN's most recent population forecasts India is expected to add over 270 million people between 2019 and 2050, while the population of Nigeria is projected to grow by 200 million. Together, these two countries alone could account for 23% of the global population increase to 2050[9].

Starting with **India**, the largest portion of our portfolio at 27%, we continue to be excited at the prospects for well-managed, consumer-facing companies with high-quality products. Over the next 30 years, India is forecast to add the equivalent of the current population of Indonesia to its already huge base of eager consumers. Numerous categories are likely to do very well but areas where we retain a keen interest include **oral care, beverages** and **retail and mortgage banking**. All are areas where we believe a well-aligned, high-quality franchise can sustain a long-term competitive advantage.

Although per capita consumption metrics can often become less meaningful when the denominator exaggerates the size of the consuming class, even on conservative assumptions India is sizeably under-indexed in each of these categories. For example, Indians currently use on average just over half as much toothpaste as consumers in the Philippines every year and drink about 80% less beer than the Chinese. Portfolio companies such as Colgate-Palmolive India and United Breweries also have product portfolios that could benefit from eventual premiumisation in their categories, but there is also still a huge volume opportunity, which we believe is not fully discounted in their share prices.

On the banking front, two-thirds of the population today are below 35 years of age, suggesting substantial demand for mortgage products in the decades ahead as household formation gathers pace. Management of both HDFC Corp and Kotak Mahindra Bank continue to demonstrate the conservative approach to risk we like to see in our financials companies. While valuation multiples have expanded, we believe they are not yet at a level that fully discounts these companies' long-term potential from India's powerful demographic tailwind.

As for **Nigeria**, it is forecast to double in size by 2050. Although an inefficient foreign exchange rate mechanism makes direct ownership of locally listed equities difficult, a prudent way of gaining exposure is through multinationals operating within the country. A good example of this is our holding in London-listed Coca-Cola HBC, which has extensive bottling and distribution interests in the country dating back to the foundation of the Leventis family's first operation in Lagos in 1951. Per capita consumption of soft drinks in Nigeria remains the lowest out of all of HBC's 28 territories and is almost half that of their next-lowest market, which is Ukraine. The potential for enduring volume-led growth also looks appealing for our other interests in the country via the local operations of Unilever and Heineken in the FMCG and brewing industries respectively.

Remembering the need for caution

India and Nigeria also provide good examples of why investing in a country with favourable long-term demographics does not necessarily lead to good outcomes for minority shareholders. If an investor had bought the index of Indian companies 10 years ago, they would have made a return in US dollars of a little over 5% annualised – well below the global index over the same period (almost 9%). Doing something similarly inadvisable in Nigeria would have yielded a loss of almost 3% annualised[10]. Both markets are skewed by financials and heavy industries in which many minority shareholders have not felt the benefit of favourable tailwinds.

Looking ahead

Our philosophy involves investing alongside managers and owners with good reputations who share our belief in a long-term approach to investment and this is an important way of aligning interests. Combining this approach with the most attractive valuation opportunities available in EM should put us in good stead for the demographic shifts ahead.

Skerryvore Asset Management (Skerryvore) is a boutique asset management team which was established in partnership with BennBridge in 2019 to create a business with the independence to pursue its differentiated investment philosophy. Our goal is to generate absolute long-term returns by investing responsibly in emerging markets. We have an unwavering focus on the quality of the businesses in which we invest.

For more information visit skerryvoream.com

1 Rosling's rounded population estimates were based on the UN's World Population Prospects: The 2017 Revision

2 'S. Korea to hand out cash rewards for birth and additional childcare subsidies', Pulse by Maeil Business News Korea, 15 December 2020, https://pulsenews.co.kr/view.php?sc=30800028&year=2020&no=1286611#:~:text=The%20South%20Korean%20government%20will,country's%20stubbornly%20low%20birth%20rate.&text=The%20first%2Dyear%20subsidy%20is,children%20aged%207%20and%20younger

3 'China birthrate slumps as experts blame changing attitudes', The Guardian, 10 February 2021, https://www.theguardian.com/world/2021/feb/10/china-birthrate-slumps-experts-blame-changing-attitudes

4 Does China have an aging problem? The Center for Strategic and International Studies, https://chinapower.csis.org/aging-problem/

5 'China's plan to raise retirement age will be gradual process, government researcher insists', South China Morning Post, 14 March 2021, https://www.scmp.com/economy/china-economy/article/3125403/chinas-plan-raise-retirement-age-will-be-gradual-process

6 'Chinese Attitudes Toward Immigrants: Emerging, Divided Views', The Diplomat, 21 December 2020, https://thediplomat.com/2020/12/chinese-attitudes-toward-immigrants-emerging-divided-views/

7 2018 figures. Taken from p.83 of the Budweiser Brewing Company AsiaPac IPO prospectus

8 UN's World Population Prospects: The 2019 Revision

9 All gross returns in USD. Respective MSCI Index used in each case

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