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# Exporting the Bacon Genie™…and Other Reasons to be Bullish on Global Macro

Americans are the world heavyweight champions of consumption…to a fault. If one doubts the validity of this assertion (and introspection alone does not confirm …which it does for this author), may I suggest spending a few hours perusing the pages of any in-flight shopping magazine. The variety of 'unique' (read useless) gems that have apparently found a market in the land of Uncle Sam include the Snuggie® for dogs, Bacon Genie®, Day of the Week Clock??? (yes, it exists…), PetSweep 'animal-powered debris removal system' with 'one-size fits most paws' booties, and of course the practical ShoesUnder™ bed box (did not the shoes come in a box???), 'designed to keep your shoes dust, moisture, and bug free'. At long last, a product for those pesky shoe bugs…hooray! Perhaps these items seem relevant and/or useful during the last 20 minutes of a blurry transcontinental red-eye flight… otherwise I would suggest not so much.

**Brooks Ritchey**
Senior Managing Director
Portfolio Construction

**Robert Christian**
Senior Managing Director
Head of Research

Clearly, the U.S. has mastered the art of conspicuous consumption — but what about the rest of the world? According to the United Nations, Asia (ex-Japan) represents 45% of the world's population, yet the region consumes less than half that of America despite having 10X the people! Said differently, there are still 3 billion potential new consumers that have joined the global marketplace over the last several decades that have yet to fully participate in it. Intuitively, the East's lack of shopping stamina is a function of many factors, including cultural, social, economic and demographic characteristics. From an ideological/philosophical standpoint, the enlightened mind that recognizes happiness and fulfillment are states of being to be achieved without material excess is of course a good thing — so I wish to be clear on that. I am not suggesting the East needs to 'Keep Up with The Kardashians' so to speak (God help us). That said I do believe there are aspects of Western consumerism that would benefit the emerging economies were they to embrace it; and would benefit the global economy as well. The good news is there are both structural and cultural shifts emerging that will allow this to happen.

In this month's letter I thought I would focus on some of these evolving trends, what I think they mean for the future, and how they evoke the need to invest portfolio's with macro considerations in mind.

**My colleague Robert Christian, Head of Research, has graciously offered to share his current view of the global macro strategy as well.**

As the Walt Disney song and theme park attraction of the same name suggests (unintentionally creepy animatronics dolls aside) it is indeed a very small world, and getting smaller each day in terms of the landscape against which investment decisions are made. Markets have never operated in a vacuum — save for the theoretical playgrounds of academia — and exogenous factors have always played a part in outcomes. More recently, however, it seems the influence and intensity of those global factors — such as socioeconomic shifts in emerging market regions of the world — are more pronounced. Even the most casual observer of Wall Street can bear witness to this reality.



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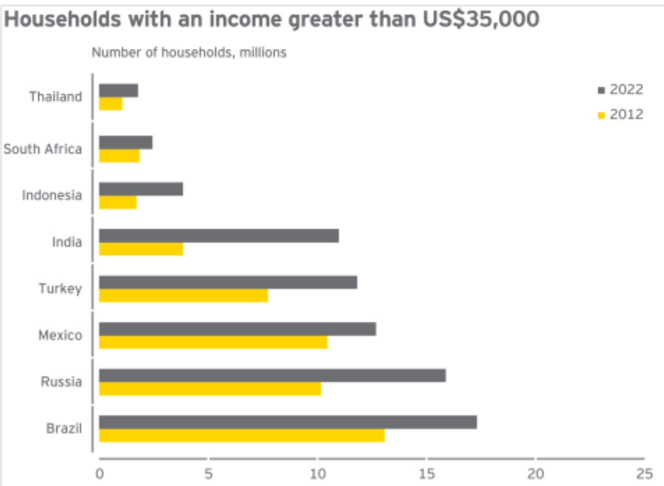
### A Global Rebalancing

Economic/structural and social tectonic plates are shifting; reflecting a paradigm change that is likely necessary if we desire sustainable growth in the future. Structurally, significant trends in the spending power across the major emerging (or rapid) growth markets are visible. According to Ernst & Young, in less than a decade there will be 200 million emerging market households with annual incomes exceeding US$35,000. This represents a dramatic change. In China alone, the number of households earning this amount is projected to triple to almost 80 million by 2022. In addition, Brazil and Russia will each be home to 15 million such households, while Mexico, Turkey and India will each have more than 10 million. Together, the middle classes of these rapidly growing markets are projected to surpass that of the US in less than 10 years, and by a meaningful margin (Exhibit A.).

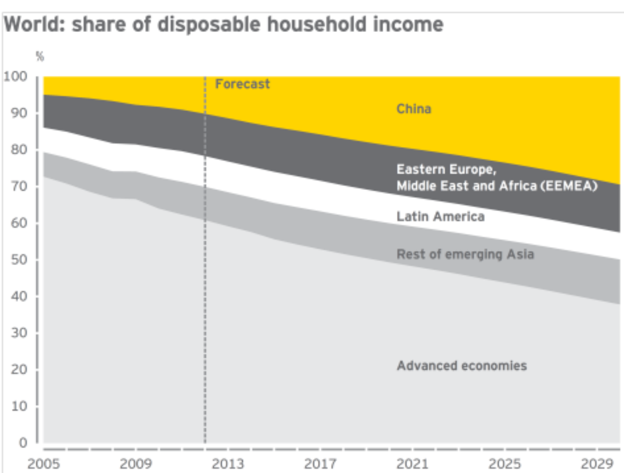
**Exhibit A.**




Source: Oxford Economics; Haver Analytics.

**The level of disposable income is projected to grow correspondingly as well (Exhibit B.).**

**Exhibit B.**




Source: Oxford Economics

Given this possibility, it appears that at least from a structural standpoint the East stands ready to take up a portion of the West's home shopping club mantle. It suggests that Asian and other emerging markets will increasingly look to their own populations to drive demand, with the growing middle class buying a wider range of goods and services. Bacon Genie anyone?

### Cultural Changes

Second, and perhaps more importantly, cultural attitudes about consumption appear to be shifting, perhaps for the better both in the East and West. That is to say popular behavior in emerging/Eastern economies is moving towards consuming more and conserving less (in a healthy way); while in the West attitudes move in the opposite direction…that is towards a more conservationist, 'mindful' and minimalist state (though perhaps not quickly enough on Bravo programming).

**In other words there are signs that the world is moving towards more consumption uniformity, and that the disparity between the Anglo-bloc and Asia is narrowing.**

Looking more closely at China in particular, there seems to be a willingness among the population to adopt more Western-centric behavior in terms of purchasing habits. Anecdotally, an article in Bloomberg Magazine last year told the story of a young Chinese mother pacing the aisles of an IKEA store in Beijing, looking for a small bed with toys for her grandson. The woman was not looking to purchase the bed, however, but rather simply seeking a place for the one-year old child to take a nap. Curious? Not so much, where according to the article, on any given Saturday afternoon every bed in the 43,000-squaremeter Beijing home furnishings store is occupied, with both children and adults fast asleep under the covers. For many Chinese, visiting the IKEA store is not necessarily about buying as much as it is about the experience (like Westerners visiting Disney's Epcot Center). IKEA naturally welcomes the trend, as more Chinese residents visit the store, eat the meatballs and trademark apple pie, the more likely it is they will consider IKEA when the time comes to actually purchase a new sofa. Given the projected growth in disposable income for the average Chinese citizen, that time appears to be quickly approaching.

In addition, the current teenage population in China was born after Tiananmen Square, coming of age in a time of economic expansion and prosperity. As such, they likely have very different attitudes about spending then their parents. For example, Chinese adolescents are surprisingly heavy users of technology, particularly given current income levels. A study by the Boston Consulting Group found that the Chinese spent more time online than people in any other large developing country. The study also found that in rural China nearly half of all Internet users were under 20, while 80% were under 30.

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Furthermore, the Chinese government has also embraced the idea of stimulating internal consumption, cultivating a more capitalist sentiment among its population with the intent of ultimately building a more sustainable economy. Chinese leaders have called this initiative the 'balanced and harmonious society' (ironically), where citizens can afford more comforts of modern life, better housing, clothing, and technology. The Chinese government is very aware of its country's changing demographic landscape, and the eventual need to rely more on internal consumption for future growth. Fewer new workers are expected to enter the labor pool (one-third less sixteen to twenty-four year olds over the next 12 years) while more senior citizens are projected to exit (Emerging Market Investment Perspectives: Morgan Stanley, March 11, 2010).

In short, China's position in the world as assembler of choice based on the cheapest and most reliable labor is gradually changing, and the country will be forced to make the transition from manufacturing economy to innovation economy, from a net exporter to net buyer.

**This is a good thing, because for the rest of the world the Chinese consumer is one of the best hopes for future prosperity. In the years ahead, if the U.S., Europe and Japan have no choice but to slow spending and tighten belts, China will hopefully be in a position to take the lead on spending.**

Indeed, millions of Americans could end up with jobs that exist, at least in part, to design, make or sell goods and services to China.

### The Re-Balance and Global Macro

For all of the emerging countries, transitioning to a service economy from an industrialized one will be difficult, certainly more challenging than that of moving from agrarian to industrial. The farmer can be moved into the city but once. Beyond that, emerging economies will need to manufacture goods that are not only cheaper than the competition, but better as well. The idea is to cultivate a healthy domestic consumption market, so that its own consumers can pick up the slack when exports inevitably slow.

Again, looking at China as a proxy, many Westerners who visit the nation are left awed by its accomplishments and explosive growth. Cities have sprouted from nothing, rural highways are smoother than many airport runways in the West, and bullet trains can cover the distance between New York and Washington in one hour. The United States is on course to have such trains…ummm never. Even for those who have not physically visited the country, one need only recall the television broadcasts depicting the spectacle and wonder that was the Beijing Olympics to appreciate the extent of China's dramatic change.

Nonetheless, the question remains, can an economy growing as rapidly as China's backfill the framework of its economic infrastructure with the mortar necessary for it to self sustain? In other words, will wages rise fast enough, consumption expand, and entrepreneurial innovation flourish? We shall see. In the interim global macro strategies stand ready to profit from the journey.

### Why Global Macro Today

***By Robert Christian, Senior Managing Director, Head of Research***

The global macro strategy in essence relies on the flow of capital around the globe to capture alpha; as we have observed we expect this flow to be meaningful in the coming years. The strategy may take positions in interest rates, bonds, and currencies primarily, but any asset class including equities can be used. The *Financial Times* describes global macro as a strategy that makes money from "macro-economic news, central bank actions, political risk, and information asymmetry". These asymmetries can sometimes be unexpected and fast acting — think Black Wednesday in September 1992 when George Soros made £1 billion by shorting sterling when the UK pulled the pound from the European Exchange Rate Mechanism; or more recently when the Swiss National Bank removed the cap on the Swiss franc's value against the Euro in January and the Swiss currency soared 30% in a single day. In addition, the asymmetries can also reflect longer term secular dynamics that are shifting as well – such as the aforementioned consumption rebalance between East and West.

**For the near term (outside of Brooks' belief in the eventual export of the Bacon Genie…), I am bullish on global macro for a number of reasons. The divergence in central bank policies around the world continues to present opportunities. While Fed officials have indicated their willingness to end the easing cycle, the significant surge in the US dollar and the collapse in oil prices present uncertainty around the timing of the first rate hike in the US. On the other hand, the ECB continues to ease aggressively providing attractive opportunities across asset classes.**

Central banks around the world are cutting interest rates to maintain competitiveness of their respective currencies, which should support the widely held long US dollar theme. While depressed oil prices have left commodity exporters such as Venezuela and Brazil in a dire state, the move has presented attractive long opportunities in oil importing countries such as India.

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Weakening growth in China presents challenges, not only for domestic assets, but also for currencies of countries with strong trade linkages, such as Australia. Potential market tail risks exist from the possibility of a Greece exit from the Eurozone due to failed negotiations with its lenders. This could present both opportunities and risks.

## The Bottom Line

The global economy is at a crossroad of sorts, facing a paradigm shift that is necessary for sustainable growth in the future. Modifications in policy and consumer behavior will be requisite in both G-7 and BRIC nations.

**In the East a pattern change in cultural thinking and behavior is evolving, such that consumption is becoming as much luxury driven as it is necessity. While in the West we could make the book *Zen and the Art of Motorcycle Maintenance* required reading in classrooms.**

I believe everyone would agree these trends are for the better — better for humanity and populations in the less prosperous parts of the world, better for the strength and sustainability of the global economy as a whole, and — as fate would have it — better for global macro investing strategies as well. And last but not least, better for bacon.

Thanks for reading.

**Brooks Ritchey**
Senior Managing Director, K2 Advisors