GLOBAL INVESTMENT THEMES

Megatrends unstoppable in driving global changes

Neil Dwane, CIO Europe of RCM, the equity managers of Allianz Global Investors, outlines the six global investment themes he believes are reshaping our world

Global investment themes can be likened to a new law of physics. By that we mean that the forces at work appear to be unstoppable in producing dramatic changes around the world.

A constant at the heart of these themes are the BRIC economies (Brazil, Russia, India and China). Each of these harbour powerful long-term structural dynamics that are putting pressure on the resources of the world and prompting change that has already begun to impact on the wider global economy.

The global economy however has sustained a significant body blow from the dramatic collapse in global industrial production as its slick "just in time" superstructure has been undermined both by asphyxiating credit contraction and plummeting consumer and corporate end demand.

So what does the path to recovery look like? Already the markets have concluded that the BRIC countries, up between 13 per cent and 42 per cent over the first third of this year, will lead the world into the next decade and beyond – and we agree.

Essentially, we are in a transition to a world economy led by emerging markets, and it is this simple truth that underpins the following themes.

INFRASTRUCTURE

This is the most overwhelming structural theme, with China as the bedrock. China has already taken an aggressive stance on growing its economy over the last 20 years. The Chinese first focused on infrastructure for their growth strategy, and that set them apart from Russia, Brazil and India.

These countries are now learning positive lessons from China's growth – namely, that to have a world-class economy you need to have a world-class infrastructure in place to support it. India has a far more rural core than China, with millions of people still farming.

However, the prevalence of the English language and India's large number of highly skilled graduates and engineers has made it a natural home for companies outsourcing some of their operations overseas.

Investing in infrastructure is paramount for India to continue this trend.

THE NEW BRIC CONSUMERS

We believe the BRIC countries will emerge from the present crisis strengthened and will continue to be economically successful over the next five to ten years. As a result they will reduce the world's dependence on the US consumer. Future growth in consumption is going to come from another part of the world – we believe the BRIC economies are going to create enormous new markets.

ENVIRONMENTAL TECHNOLOGY

Environmental technology has arisen as a major investment theme in its own right, and alternative energy is becoming a mainstream business. We have a global economy that needs energy, but there is only a finite supply of oil available in the world.

Companies producing alternative energy should do well as a result, as people are turning to these sources of energy to meet their essential needs. At the same time, there is growing pressure in the form of domestic and international legislation aimed at combating climate change. These changes in legislation show no sign of abating – directives are actually becoming tighter.

In addition, lifestyles are changing globally as people embrace the importance of protecting the environment. Today, there are huge incentives for people to invest in alternative and cleaner energy solutions.

AGRICULTURE

Agricultural prices are one of the main drivers of global inflation scenarios. As emerging economies demand changes, they are putting specific pressure on the food infrastructure of the world.

The price of 2.8bn people coming into the global food chain properly is having a big impact on availability – not only are people eating more, they also demand better quality food. Global wheat supplies are very low, and it is wrong to assume that supply can quickly be adjusted to meet higher demand.

Increasing long term demand from emerging markets for better quality food, ethanol production diverting land away from food production, and sharply higher farm input prices are the cocktail of factors coming together to drive change.

ENERGY

Developed economies rely on oil to keep the wheels of their lifestyle in motion, with rising numbers of consumers turning to the roads despite the volatile cost of fuel. However, emerging markets are arguably becoming as dependent on oil as the West.

As a result there is true global competition in energy markets, and the question of which country wants to pay the most to secure its energy needs means that energy price inflation has only just begun.

While oil is the most obvious commodity that we feel we need professionally and personally, the entire Western world shuts down without electricity. We are reliant on the internet, and our electrical systems cannot be allowed to fail.

COMMODITIES

The challenge for many of the emerging markets, such as China or India, is that they do not have sufficient commodities to grow their economies.

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Over the long term, their demand for commodities will proceed to push up price levels on a global level. It is clear that there is a shortage of resources, so countries are working to find an optimal balance between requirements and stock levels.

The pressure on commodity supplies may lead to trade wars as countries seek to keep their domestic populations happy; already we are seeing higher taxes on exports and outright bans in producing countries.

Furthermore, when the emerging markets have risen to become world class economies, the developed world is going to have to rebuild in order to catch up. The costs of this will be enormous and there will be a long-term sustainable demand for commodities like cement, steel and copper.

GLOBAL OUTLOOK

The present credit crunch is slowing investment in many areas of the global economy, from farming to infrastructure projects and trade. All of this will tighten the supply-demand balance which has been powerfully at work in many of these fundamental industries over the last five years.

It is now reasonable to conclude that as the world will stabilise from this emergency, pressures on pricing will return quickly and allow the capital expenditures to meet the still-present global needs from food through to oil and other commodities.

In the US, Barack Obama has outlined clear strategic points to boost employment, promote greener energy and more sustainable energy projects, and to return the US to economic health. The latter will stimulate the global economy, and a move to more self-sufficiency and greener energy will boost investment in environment-friendly sources and technologies.

The first part of the plan will include massive infrastructure investments which could fuel higher demand for exactly those commodities which are so needed by the emerging and BRIC countries, so that we could see explosive demand as the plan gathers steam.

CORPORATE STATEMENT

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Allianz Global Investors

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