

## ANOTHER BRIC IN THE WALL

A look at the next big players  
in emerging markets



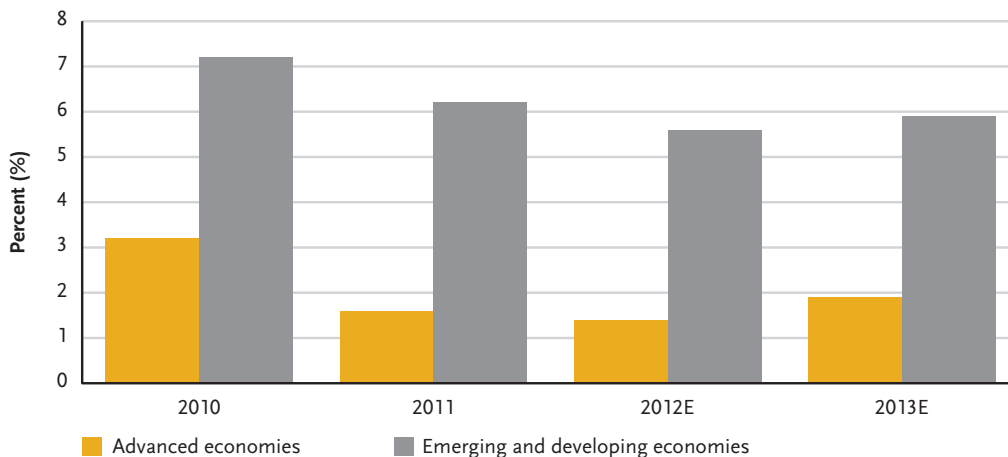
By Stephen Way  
 Senior Vice-President and Portfolio Manager  
 AGF Investments Inc.

As the U.S. and eurozone superpowers struggle to right themselves financially, emerging markets (EM) have been a key source of growth for the global economy in recent years (Exhibit 1). But even these markets have not been immune to weakness. While the long-term outlook for these markets is encouraging—supported by positive macroeconomic fundamentals, including rising domestic consumption and infrastructure spending—EM investors have had their confidence tested recently.

The current reality of muted global growth, volatility and uncertainty is likely to continue due to ongoing deleveraging in the developed world and financial problems in Europe. However, rising domestic consumption in EM economies will likely help offset this to some extent.

According to the July 2012 IMF World Economic Outlook Update, imports have continued to grow at a faster pace in emerging economies than in developed economies (8.8% versus 4.4%, respectively) in 2011, and this is projected to continue into 2013.<sup>1</sup> Additionally, wage increases in EM countries—such as South Africa, which had an average annual wage growth of 7% for the five-year period from 2006 to 2011<sup>2</sup>—point to rising consumption trends.

**EXHIBIT 1: GDP Growth Rates (%)**



Source: IMF World Economic Outlook Update, July 16, 2012.

## BRIC

But while import and consumption trends are strong in many EM countries, the more familiar BRIC contingent (Brazil, Russia, India and China), long touted the next generation of powerhouse economies, is experiencing a slowdown.

India is facing fiscal and trade deficits that are not likely to be resolved quickly, and political paralysis has put many infrastructure projects on hold. For example, in 2010, the National Highways Authority of India cancelled the Goa road project because of its inability to acquire land for the project due to lack of land reform.

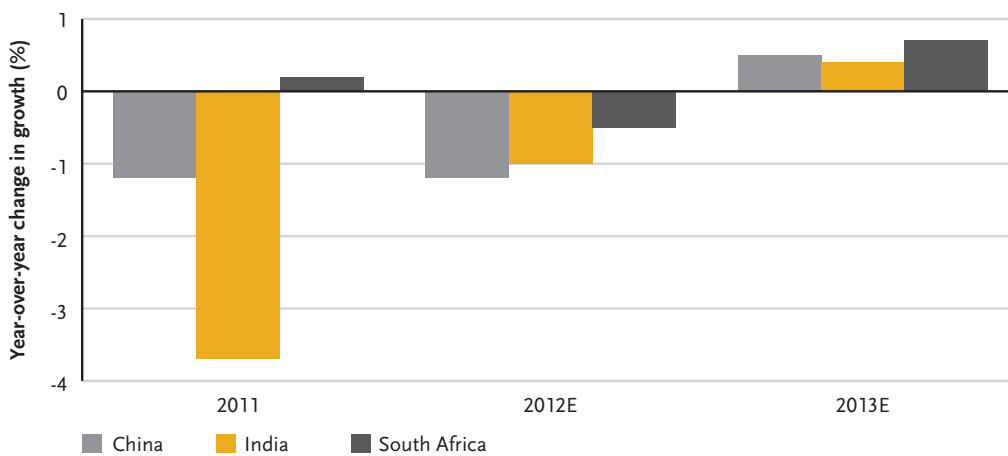
<sup>1</sup> IMF World Economic Outlook Update, July 16, 2012. GDP growth in 2012 and 2013 are estimates.

<sup>2</sup> Source: Bloomberg, December 31, 2011

China, following a massive injection of liquidity during the post-financial crisis period, is attempting to address imbalances arising from capital misallocation at the private and local state levels by providing more targeted support to domestic growth in areas such as the auto sector. Growth rates in China and India slowed considerably in 2011 and are expected to continue to decelerate in 2012, albeit at a slower pace (Exhibit 2).<sup>3</sup>

In stark contrast, some peripheral economies within the EM contingent are demonstrating a new-found resilience as governments implement structural changes to stimulate internal growth. Despite the global slowdown in growth, South Africa's change in growth was only marginally affected in 2011 and 2012, according to the July 2012 IMF World Economic Outlook Update (Exhibit 2).

**EXHIBIT 2: Resilience in non-BRIC Growth Rates (%)**



Source: IMF World Economic Outlook Update, July 16, 2012.

This variance in the deceleration of growth across the EM economies highlights the importance of why institutional investors should look beyond BRIC to bolster their portfolios. Others to watch on the EM stage include South Africa, Mexico, Thailand and South Korea. These countries in particular have exhibited positive domestic economic fundamentals, rising consumption trends, healthy savings rates and sound financial institutions. They are also highly competitive internationally, enabling them to thrive in the global economy.

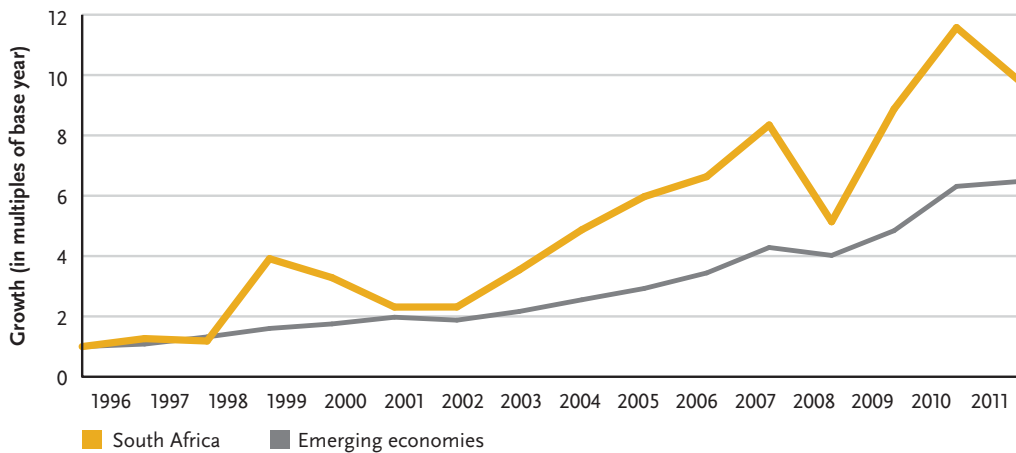
## South Africa

South Africa's economy has experienced dramatic growth and transformation since policy-makers began implementing a series of reforms in 2004. In addition to benefiting from reforms to control inflation and stabilize public finances, the country has also gained from the rising global demand for commodities. The resulting improvement in employment conditions has attracted foreign direct capital investment (Exhibit 3). Net foreign reserves (which include gold and currency) have continued to expand, reaching all-time highs of approximately US\$50 billion in February 2012.<sup>4</sup>

<sup>3</sup> IMF World Economic Outlook Update, July 16, 2012. GDP growth in 2012 and 2013 are estimates.

<sup>4</sup> Bloomberg, July 18, 2012.

EXHIBIT 3: Inward Foreign Direct Investment (Growth since 1996)



Source: United Nations Conference on Trade and Development, July 2012

The region’s financial institutions have been extending more credit to relatively good-quality borrowers. This growing wealth effect among South African consumers bodes well for retail spending, which has grown significantly in the last few years, and grew by 6.4% on a year-over-year basis in May.<sup>5</sup> For example, Woolworths Holdings Ltd., which operates a food and clothing business in more than 400 retail stores, is poised to take advantage of the increase in consumer spending. The positive domestic fundamentals position the firm to grow its gross sales and operating margins.

## Mexico

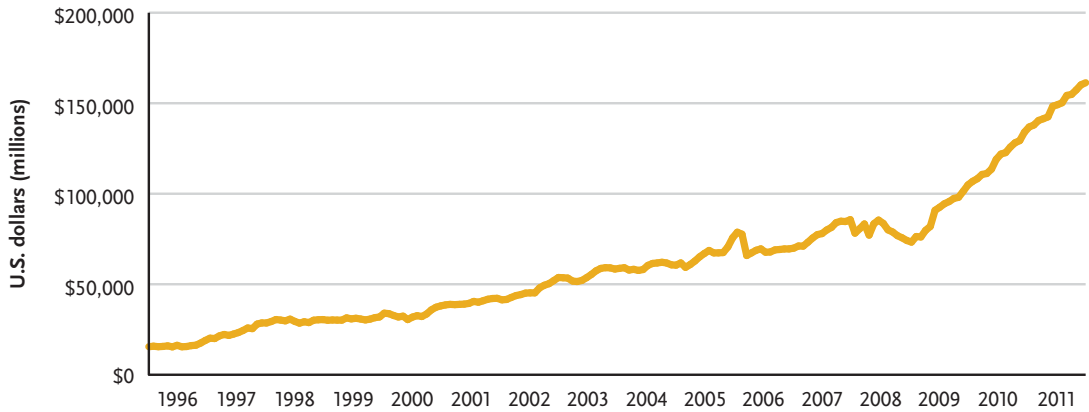
Mexico has recently had its many positive economic attributes overshadowed by headline security concerns, and it has learned its lessons from previous crises that nearly caused the country to default on its debts. In recent years, the government has been implementing fiscal discipline and strengthening the banking system (so that it is now fully capitalized and compliant with Basel III, an international regulatory framework for banks to strengthen risk management and the ability to withstand shocks). It has also introduced reforms to enhance competitiveness, such as increasing powers for Mexico’s Federal Competition Commission to combat monopolies and oligopolies.

Over the past decade, government spending on infrastructure, housing and social programs in Mexico has spurred domestic economic growth. Mexico recently refinanced its external debt at lower rates and has accumulated more than US\$157 billion<sup>6</sup> in foreign reserves, putting it in a healthy fiscal position (Exhibit 4). The government’s conservative fiscal policies have also helped strengthen the peso. With steady inflation close to the target rate of 3.5%, Mexico can afford to maintain lower borrowing rates, thus putting money into the hands of consumers to redistribute into the economy.

<sup>5</sup> Bloomberg, July 18, 2012. In constant 2008 prices.

<sup>6</sup> Bloomberg, July 13, 2012.

**EXHIBIT 4: Mexico's Net International Reserves**



Source: Banco de Mexico, September 2012

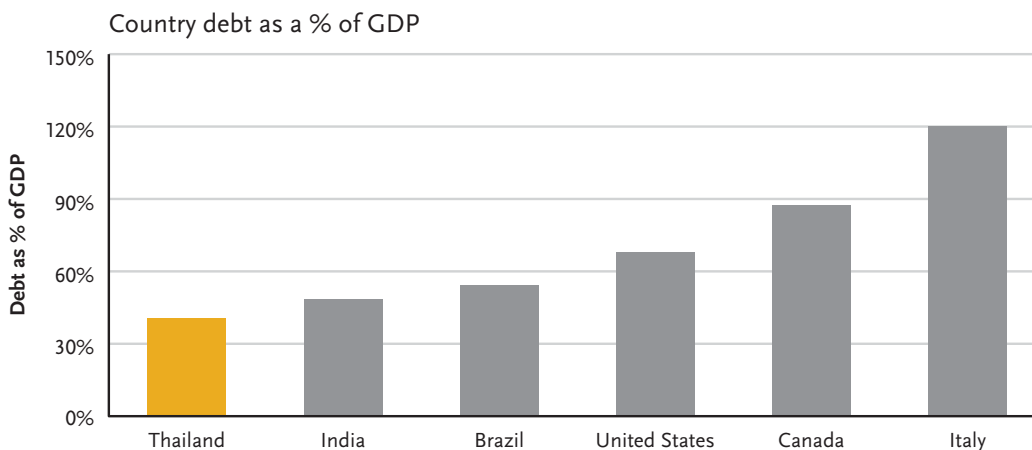
While wage growth has not been as heated as in other EM countries, Mexico has experienced a similar evolution in consumer affordability and lifestyle changes. One company set to benefit from the rising consumption trends is Mexico's leading supplier of consumer tissue products—Kimberly-Clark de México—which has a portfolio of leading brands, including Kleenex, Huggies and Kotex. The company has achieved sales growth of 8% year-over-year and looks to gain market share as it moves into new category segments and distribution channels such as hospitals.

The outlook for Mexico is likely to continue improving, as the domestic sectors benefit from positive consumption and income trends while headwinds from a weak U.S. recovery and European uncertainty gradually ease.

## Thailand

Following a year of devastating floods and widespread destruction to capital and infrastructure, Thailand's GDP growth could rebound strongly this year because of reconstruction spending injections from private and public institutions. The Thai government has a sound balance sheet, with a debt-to-GDP ratio of approximately 41% (Exhibit 5), which is lower than most European countries, including that of France and Spain (at 85% and 68%, respectively).<sup>7</sup> Thai listed companies have also been resilient, making a strong rebound across all industries in the first quarter of 2012, according to The Stock Exchange of Thailand.

**EXHIBIT 5: Thailand's Debt-to-GDP Lower than Most Developed Nations**



Source: Bloomberg, September 2012

<sup>7</sup> Bloomberg, July 23, 2012.

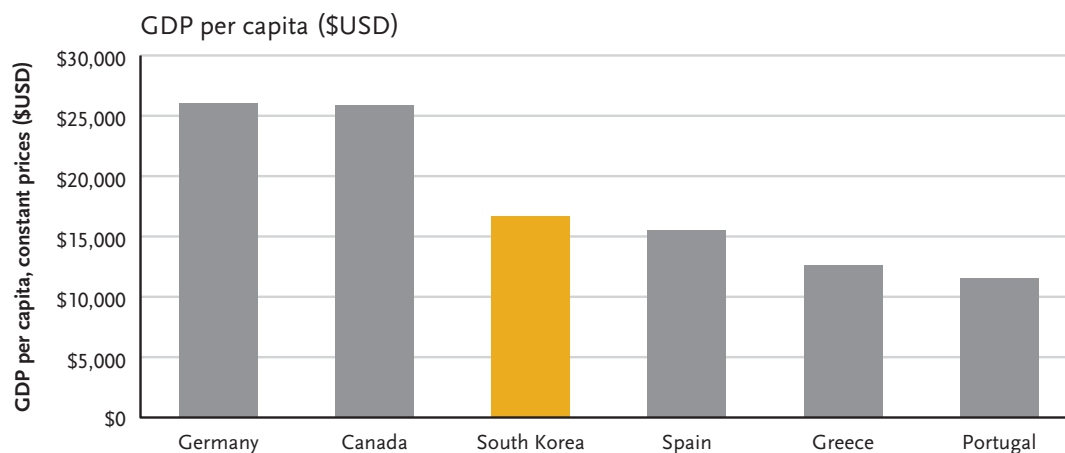
The country has benefited from China’s growth and intra-regional trade in Asia, but it has also learned from history. The Asian crisis of the late ’90s, among other things, shone a light on deficient government and private citizens’ savings levels, underscoring the need for change.

Thailand’s large banks have loyal customer bases, and price competition is limited. With a healthy growth in deposits thanks to rising incomes, Thailand’s third-largest commercial bank, Kasikornbank Public Company Ltd., maintains a portfolio balanced between corporate and retail banking, and boasts one of the highest loan yields and spreads of any of the large Thai banks. The positive market fundamentals and declining pressures on operating expenses should enable the company to generate even higher profits.

## South Korea

Dubbed one of the Four Asian Tigers, South Korea has been one of the world’s fastest-growing economies since the early 1960s and is one of the most industrialized members of the Organisation for Economic Co-operation and Development. In 2011, South Korea’s GDP per capita was more than US\$16,500, exceeding that of Spain, Greece and Portugal (Exhibit 6).

**EXHIBIT 6: South Korea: Still Going Strong**



Source: CIA World Factbook, December 2011

As a heavily trade-dependent nation—South Korea ranks among the top 10 in terms of exports and imports in the world, according to estimates from the CIA’s 2011 *The World Factbook*—the country boasts companies that have dominated their home market and evolved into highly competitive businesses now set to compete on the global stage.

A perfect example is global giant Samsung Electronics, which has conquered the consumer electronics market in Asia and is a formidable competitor against Apple in the fast-growing smart phone and tablet market. According to a July 2012 article in *Business Insider*, in Q2 2011, Samsung shipped 20.2 million units of smart phones. By Q2 2012, the units shipped had grown to 50.5 million, representing an increase in global smart phone vendor market share from 18% to 35%. In comparison, Apple shipped 20.3 million units in Q2 2011 and 26 million units in Q2 2012; its market share remained steady at around 18%.

## With Opportunities Come Risks

Emerging markets offer tremendous opportunities, but investors should be aware of their risks. These markets are typically more volatile than many developed markets. This is partly due to heightened political and economic risks, as the countries transition to free-market economies and implement various reforms.

Investors must also consider the inherent risks of investing in markets with a short track record of foreign investment or investing in relatively early-stage companies. This is in addition to the usual threats of stock price fluctuations, liquidity, inflationary pressure and local currency volatility.

Despite these risks, EM countries will likely remain key contributors to global growth well into the future. The healthy states of sovereign finances, trade balances, savings rates and employment trends have given governments in these countries the ability and resources to stimulate growth at home to offset some of the weaknesses seen globally. Policy reforms should continue to bring about structural improvements and productivity advancements, which should be positive for domestic economic growth in the long run.

Investors looking for global growth and willing to consider accepting the risks associated with emerging markets would do well to invest beyond BRIC—and gain the diversification benefits considered vital to long-term investing.

### Important information:

AGF Investments is a group of wholly owned subsidiaries of AGF Management Limited, a Canadian reporting issuer. The subsidiaries included in AGF Investments are AGF Investments Inc. (AGFI), AGF Investments America Inc. (AGFA), AGF Asset Management (Asia) Limited (AGF AM Asia), AGF International Advisors Company Limited (AGFIA) and AGF International Advisors Ltd. (AGFIA Ltd.). AGFA is a registered advisor in the U.S. AGFI is registered as a portfolio manager across Canadian securities commissions. AGFIA and AGFIA Ltd. are also regulated by the Central Bank of Ireland. AGF AM Asia is registered as a portfolio manager in Singapore. The subsidiaries that form AGF Investments manages a variety of mandates comprised of equity, fixed income and balanced assets.

As of September 30, 2012, AGF Investments now includes AGFIA and AGFIA Ltd. The firm definition was redefined in order to include AGFIA and AGFIA Ltd. under the AGFI brand to centralize operational functions from a GIPS perspective.

Except where defined for GIPS purposes herein, AGF Investments is a registered trade name of AGF Investments Inc. that includes the following affiliated entities: Acuity Investment Management Inc., AGFIA Limited, Highstreet Asset Management Inc. and AGF Investments America Inc.

AGF Investments America Inc. is a registered adviser in the U.S. AGF Investments Inc., Acuity Investments Management Inc, Highstreet Asset Management Limited and AGFIA Limited are registered as portfolio managers across various Canadian securities commissions. AGFIA Ltd. is also regulated by the Central Bank of Ireland. The entities are affiliated and wholly owned by AGF Management Limited, a Canadian reporting issuer.

The commentaries contained herein are provided as a general source of information based on information available as of September 2012 and should not be considered as personal investment advice or an offer or solicitation to buy and/or sell securities. Every effort has been made to ensure accuracy in these commentaries at the time of publication, however accuracy cannot be guaranteed. Market conditions may change and AGF Investments accepts no responsibility for individual investment decisions arising from the use or reliance on the information contained herein.

### This document is for use by accredited investors only.

References to specific securities are presented to illustrate the application of our investment philosophy only and are not to be considered recommendations by AGF Investments Inc. The specific securities identified and described in this presentation do not represent all of the securities purchased, sold or recommended for any portfolio managed by Stephen Way, and it should not be assumed that investments in the securities identified were or will be profitable.

## AGF INSTITUTIONAL OFFICES

### TORONTO

66 Wellington Street West, Suite 3300  
Toronto, ON M5K 1E9  
**Phone:** 416 367-1900  
Toll Free: 1 888 243-4668

### BOSTON

53 State Street, 13th floor  
Boston, MA 02109  
**Phone:** 617 742-3290  
Toll Free: 1 866 622-2438

### HONG KONG

20/F Central Tower  
28 Queen's Road, Central, Hong Kong  
**Phone:** 852 3107 3220

### DUBLIN

34 Molesworth Street  
Dublin 2  
Ireland  
**Phone:** + 353 1 661 3619

### BEIJING

Suite 11A16, Tower A, Han Wei Plaza  
No. 7, Guang Hua Road, Chao Yang District  
Beijing 100004, China  
**Phone:** 86-10 8526-1820x15

[www.AGF.com/Institutional](http://www.AGF.com/Institutional)



AGF is proud to sponsor  
World Wildlife Fund,  
protecting the tiger and  
other endangered species.

AGF is dedicated to helping develop business solutions for industry demands on natural resources. We are proud to partner with the World Wildlife Fund in protecting endangered species, such as the Sumatran Tiger, and ensuring a sustainable environment for future generations. As a result, this document is printed on Forest Stewardship Council® (FSC®) certified paper. FSC® certification ensures that the paper in this document contains fibre from well-managed and responsibly harvested forests that meet strict environmental and socio-economic standards.