



October 2009

Newton's *developing economies* theme

Our investment approach is founded upon the use of themes. In this article, we explain how one of our themes, *developing economies*, influences our investment decisions.

The use of themes at Newton

Our themes represent our ideas about the likely forces of change in the world. Our global, thematic philosophy and process allow us to gain long-term perspective on global financial markets and economies, to anticipate how the world will change and to identify the beneficiaries of (and threats from) such change.

There is no shortage of information in the modern world, but information without perspective lacks resonance. The perspective we gain from the application of our themes is a defining feature of our investment process; it helps us to anticipate how the world will change and it directs our analysts and investment managers towards profitable investment opportunities across the world.

Our long-term investment philosophy and fundamental research have proved consistently to be key elements in overcoming the short-term uncertainties that afflict financial markets and challenge investors. As well as delivering strong risk-adjusted returns, our approach has involved a transparency that is essential in the building of longstanding relationships with our clients.

A central tenet of Newton's approach, which dates back to the inception of the firm in 1978, has been that '**change leads to opportunity**'. The world is changing constantly and it follows that, to be fruitful, an investment approach must be dynamic enough to take advantage of such change. The continually evolving nature of our global themes allows us to understand how the world is changing and to identify areas of opportunity and risk.

Our themes evolve over time and we introduce new themes as we identify prospective changes around the world. In recent times, we have introduced new themes such as *all change* (in 2008) and *low-end spend* (in 2009), which capture the changes that we think are inherent in the post-credit-crisis world.

Among established ideas is our *developing economies* theme, which has been in place throughout the last decade and which identifies the opportunities intrinsic in the growing influence of developing economies on patterns of global trade, resource demand and consumption.

Developing economies

The influence of the developing world on the global economy continues to grow, and developing nations ultimately are on a convergence course, in terms of demographics and consumption trends, with the industrialised world. The map below illustrates how significant many of the developing nations are in terms of their population sizes (each country's size in the map is shown in proportion to its population), and we believe that the population dynamics of a number of these nations give rise to significant investment opportunities.



The long-term, secular growth of developing economies will entail, among other things, the development of Western-style health and social security systems, and the growth of developing economies will be subject to significant cyclical influences as well as frictions regarding trade policies.

Although the trends identified by the theme are broadly applicable across the developing world, we contend that underlying economies will diverge significantly and that investors must be selective about the nature of their exposure to developing markets.

Our use of the *developing economies* theme, as with our use of other themes, is not prescriptive as to portfolio construction. In short, our investment process may be described as ‘bottom-up’; we select specific securities in seeking to fulfill each of our clients’ investment objectives. We do not assign a specific ‘top-down’ view or a fixed allocation to equities listed in developing markets. Instead, the *developing economies* theme (in common with all our themes) is intended to alert us to areas of stock-specific opportunity, and exposure to developing economies derives from bottom-up stock selection.

The *developing economies* theme may alert us to companies based in and/or listed in developed markets, whose exposure to the favourable trends evident in developing economies may make them attractive investment prospects. In any event, our analysts look in detail at the fundamental attributes of companies (including balance sheets, cashflows, corporate governance and operational issues) and they analyse particular companies rather than ‘developing-economy’ stocks or ‘emerging-market’ stocks as an asset class.

Among the trends identified by our *developing economies* theme are:

- Strong growth in incomes (from a low base), high savings rates and, in contrast with many developed economies, low household and institutional indebtedness

- The ‘Westernisation’ of tastes and the convergence of corporate governance standards
- The increasing influence of developing economies on demand for resources
- Resource and infrastructure constraints (particularly in relation to water, oil and agricultural commodities)
- Urbanisation, declining agricultural productivity, ageing populations and rising dependency ratios in some developing nations
- ‘Mercantilist’ policies, US\$ pegs, inflationary pressures and current account surpluses
- Increasing exports of value-added products and services.

Among the opportunities and risks to which the theme gives rise are:

- Domestic consumer goods and services; financial, real estate, food retail and distribution, healthcare, travel and leisure sectors
- Infrastructure/environmental spending, agriculture and food production
- Western brands and luxury goods
- Positive currency trends in the longer term
- Protectionism and ‘anti-globalisation’ risks
- Cyclical swings in sentiment are likely to cause volatility in financial-market returns
- Environmental stress may limit Western convergence and economic growth
- Increased consumption and rising dependency ratios are likely to squeeze surplus savings.

This is a financial promotion and is not intended as investment advice. The opinions expressed in this article are those of Newton Investment Management Limited. Past performance is not a guide to future performance. The value of investments, and income from them, is not guaranteed and can fall as well as rise due to stock market and currency movements. When you sell your investment, you may get back less than you originally invested. The opinions expressed in this article are those of Newton Investment Management and should not be construed as investment advice.

Issued by Newton Investment Management Limited, The Bank of New York Mellon Centre, 160 Queen Victoria Street, London EC4V 4LA. Registered in England No 1371973. Newton Investment Management Limited is authorised and regulated by the Financial Services Authority.

www.newton.co.uk