

Emerging Markets (EM) Equity

Viewpoints – The Evolving EM Consumer

Over the last decade, the dominant driver of EM growth has transitioned from commodities to consumption and technology. The EM consumer has also evolved as many are millennials with different behavior and consumption patterns. In this month's viewpoints, we delve into the *millennial consumer*, who we believe has long-term implications for EM growth, equity markets and industries.

Who are Millennials?

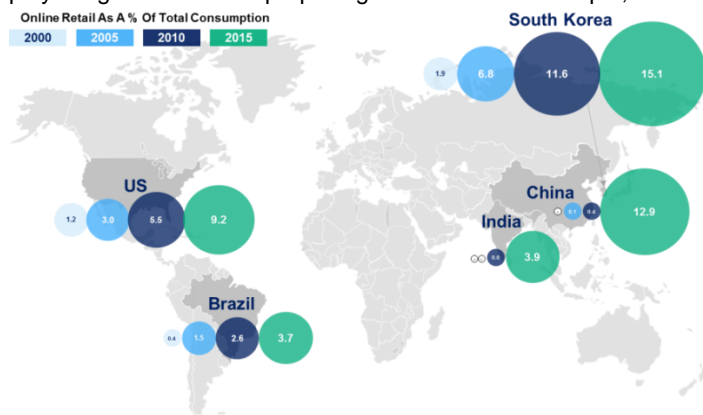
The term *millennials* refers to people born in the 1980s and 1990s – in other words, people between their late teens and their mid-30s today. Emerging markets are the home of 86% of the world's millennials,¹ accounting for almost two billion people. In both China and India there are over 400 million – more than the combined working population of the United States and Western Europe.²

Potential Investment Opportunities Arising from the Millennial Effect

Consumer behavior and consumption patterns are changing and new industries and opportunities are emerging, driven by wealth creation and the rise of the millennial consumer. The *millennial effect* is creating disruption and guiding future EM growth drivers across three key themes: digitalization, leisure and experience, and premiumization.

1. Digitalization

With the rise of the internet, online retail has disrupted traditional retail channels globally. As per the chart below, tech-enabled consumption in EM could continue to outpace that of the US,³ which not only sets the stage for e-commerce platforms to thrive, but can create opportunities across the supply chain, such as for delivery and logistics companies. As “digital natives”, millennials play a significant role in propelling this trend. For example, millennials in China are making over 40% of their purchases online.⁴



2. Leisure and Experience

Millennials have different priorities and consumption preferences from that of their parents' generation, who were largely preoccupied with improving their basic living standards. With increased emphasis on experiences, recreation and well-being, millennials are also spending more on leisure activities, self-improvement, travel, health, eating out, furniture, beauty products and apparel. These industries are still largely underrepresented in traditional market-cap weighted benchmarks, and investors must go beyond this generic universe to properly capture these early stage growth opportunities in our view.

3. Premiumization

As a result of their increasing purchasing power and changing priorities, millennials are more willing to pay for perceived quality, a phenomenon called premiumization. In China for example, the premium segment has seen disproportionately strong growth over the past few years across a wide range of consumer industries.⁵ In our view, the investment implications of premiumization go beyond “luxury” western brands. Innovative EM companies have also been able to benefit by leveraging their understanding of local tastes and demands, such as Korean cosmetic companies and food and beverages companies in China.

The disruption caused by the *millennial consumer* is creating exciting opportunities to capture the future growth in EM and thus we believe it is imperative that investors be selective and look beyond the benchmark to exploit this change.

¹ Source: Bank of America Merrill Lynch, “Generation Next – Millennials Primer”. As of May 2015.

² Source: UN Population Division, “World Population Prospects: The 2017 Revision”, data shown for 2015. As of June 2017.

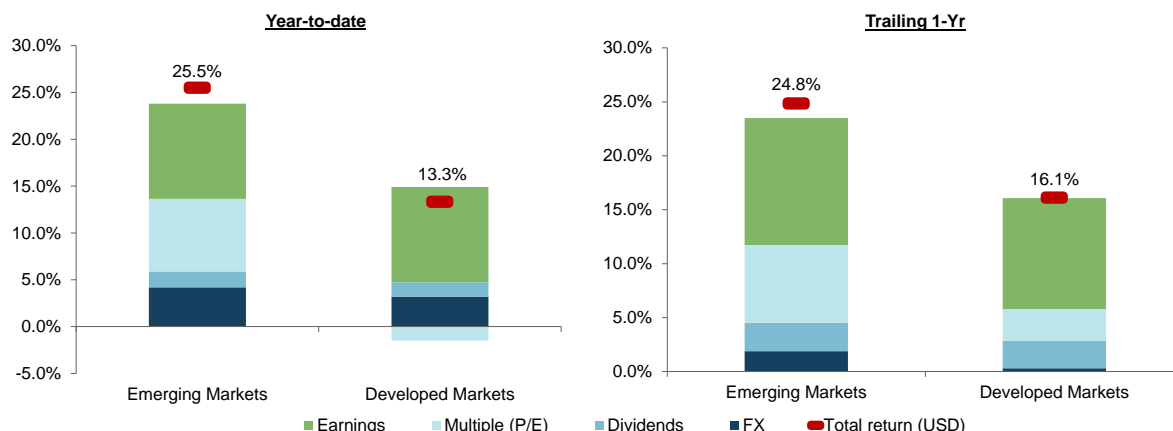
³ Source: Euromonitor, GS Global Investment Research, and GSAM, as of Jun-2016. Online retail as a % of total consumption was not measurable for China until post 2005, and for India, post 2010.

⁴ Source: Goldman Sachs Global Investment Research, “The Asian Consumer: Chinese Millennials”, as of September 2015.

⁵ Source: Kantar Worldpanel (Bain analysis), Goldman Sachs Global Investment Research, “The Asian Consumer: Chinese Millennials”, as of September 2015.

Appendix

Decomposition of total return – emerging markets versus developed markets



Source: DataStream, MSCI, GSAM Calculations, as of 31-Jul-17. Shown for MSCI EM and MSCI World indices (net, USD).

Performance – Emerging Markets country and sector breakdown

As of 31-Jul-17	July	YTD	Trailing 1-Yr
EM	6.0%	25.5%	24.8%
DM	2.4%	13.3%	16.1%
USA	2.0%	11.4%	15.3%
Europe	3.0%	18.8%	19.7%
Japan	2.0%	12.1%	14.2%

Source: DataStream, MSCI, as of 31-Jul-17. Shown for MSCI EM, MSCI World, MSCI USA, MSCI Europe and MSCI Japan indices (net, USD). **Past performance does not guarantee future results, which may vary.**

EM valuation breakdown

	Trailing Price to Earnings (x)	Forward Price to Earnings (x)	Price to Book (x)	Dividend Yield (%)	Implied 'Z-score' ¹	Implied '%-time cheaper' ²	Next 12m Earnings Growth (%) ³	YTD change in expectations (pp) ³
EM	15.5	12.5	1.7	2.3	0.27	61%	16.5	+1.9
DM	21.6	16.8	2.3	2.4	0.85	80%	11.4	-1.6
US	23.6	18.4	3.2	2.0	1.19	88%	10.9	-1.5
Europe	21.2	14.9	1.8	3.3	0.69	75%	13.8	-1.0
Japan	15.8	14.3	1.4	2.1	0.04	52%	10.7	-0.5

Source: MSCI, DataStream, FactSet, GSAM Calculations, as of 31-Jul-17.

¹ Implied 'Z-score' is the aggregate standardized score of Trailing Price to Earnings, Forward Price to Earnings, Price to Book and Dividend Yield. It represents the number of standard deviations away from historical average the current observation lies (greater than zero implies more expensive than historical average, less than zero implies less expensive than historical average). Calculated over the last 10 years, or longest available period if data availability is less than 10 years.

² Implied '%-time cheaper' represents the left-tail area of the assumed normal distribution of historical observations. It is not, therefore, an empirical representation of '%-time cheaper', but an approximation of how often the market has been cheaper than it currently is assuming the data is normally distributed. Calculated over the last 10 years, or longest available period if data availability is less than 10 years.

³ Next 12 months expected percentage growth in earnings. YTD change refers to the increase/decrease in percentage point terms versus the end of last year's observation. E.g. If the 12m earnings growth expectation at the end of March was 10%, versus 5% at the end of December, the YTD change in earnings expectations would be 5%. Colors represent a gradient of most attractive (green) to least attractive (red).

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MSCI Emerging Markets (EM) Index: The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of June 30, 2017 the MSCI Emerging Markets Index consisted of the following 24 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Russia, Qatar, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates. This Index offers an exhaustive representation of the Emerging markets by targeting all companies with a market capitalization within the top 85% of their investable equity universe, subject to a global minimum size requirement. It is based on the Global Investable Market Indices methodology. This series approximates the minimum possible dividend reinvestment. The dividend is reinvested after deduction of withholding tax, applying the rate to non-resident individuals who do not benefit from double taxation treaties. MSCI Barra uses withholding tax rates applicable to Luxembourg holding companies, as Luxembourg applies the highest rates.

MSCI Europe Index: The MSCI Europe Index captures large and mid cap representation across 15 Developed Markets (DM) countries in Europe. DM countries in Europe include: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the UK With 445 constituents, the index covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe.

MSCI Japan Index: The MSCI Japan Index is designed to measure the performance of the large and mid cap segments of the Japanese market. With 320 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

MSCI United States of America (USA) Index: The MSCI USA Index is designed to measure the performance of the large and mid cap segments of the US market. With 635 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the US.

MSCI World Index: The MSCI World Index is a broad global equity benchmark that represents large and mid-cap equity performance across 23 developed markets countries. It covers approximately 85% of the free float-adjusted market capitalization in each country and MSCI World benchmark does not offer exposure to emerging markets.

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⁷ Source: MSCI

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