# The Search For New Emerging Markets

## Asia : Betting on Southeast Asia

### Confluence of positive factors laying groundwork for strong growth

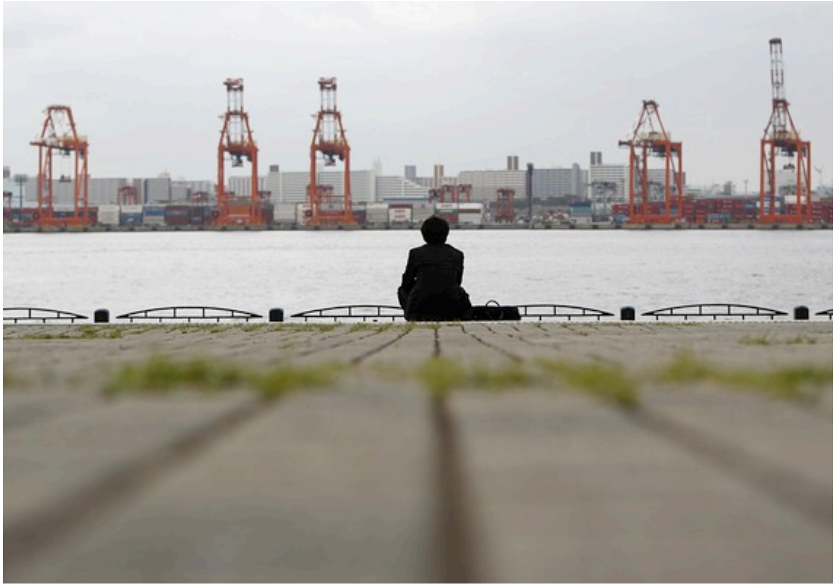
During the Asian financial crisis of the late 1990s, Indonesia and the Philippines were bailed out by the International Monetary Fund. Southeast Asia's two most populous nations are well placed to lead the region's growth for several years to come, as traditional Asian heavyweights China and India lose some momentum.

With rapidly growing economies and rising incomes, the two countries are home to a large and young labor force, an expanding middle class and have stable, elected governments with policies inspiring investor confidence. They also have sturdy banks and enough foreign-exchange reserves — more than a year's imports in the Philippines's case — to rebuff a misguided run on their currencies.

In an economically vibrant Southeast Asia, Indonesia and the Philippines stand out as the region's "New Tigers" with the potential to leave a bigger imprint on global growth for years to come while the developed world struggles with excess debt and traditional regional heavyweights China and India lose momentum.

## Indonesia and Philippines come of age

Each country has received credit rating upgrades since 2011, with Indonesia now rated investment grade by Moody's and Fitch. Their stock markets are among the world's best performing since the end of 2008 — Indonesian shares tripled during the period from beaten-down valuations, and are closely followed by Philippine equities.



Unlike the West, government finances are shipshape. Jakarta's gross government debt was 25% of GDP in 2011, and Manila's 41%, according to IMF data, leaving both enough room to boost their economies in case of need.

The Philippines has a current account surplus of 2.74% of its GDP, thanks to remittances from its vast diaspora. Indonesia swung to a deficit in the first half of this year as lower commodity prices hurt exports, and as imports of capital goods and machinery increased.

Agriculture employs at least a third of the workforce in both countries, and domestic consumption is an important driver of their economies. That protects them from external shocks to an extent — both escaped a recession in 2009, when the Thai, Malaysian and Singaporean economies contracted. But both also need tens of billions of dollars in foreign direct investment, especially to create infrastructure and pursue industrialization.

Stocks are more expensive than in north Asia, and the two nations are by no means immune to global shocks. But barring a post-Lehman Brothers-like blowout crisis — in or outside the euro zone — potential reward is seen outweighing risk on balance. Investors have embraced the local stock markets, driving shares in Indonesia up about 11% year-to-date, while Philippine stocks have climbed 22%.

The earnings growth in these markets has also been very, very strong. That gives me the confidence that as long as the earnings growth trajectory is sustainable, which we think it is, the returns will be there to be made going forward.

## Indonesia

With a GDP of nearly $850 billion and a population of 241 million people in 2011, Indonesia was by far the largest of the ASEAN economies. But half the country's population still lives on less than $2 a day, according to the Asian Development Bank.

As the world's largest archipelago straddling the equator in the Indian Ocean, it's spread far and wide. The capital Jakarta is relatively more developed, but the country faces a serious need for infrastructure and connectivity. And despite frustrating delays to various projects, many observers seem confident President Susilo Bambang Yodhoyono's government is getting its act together.

For equity investors, meanwhile, the relatively small market size is a constraint. Despite being the ASEAN's largest economy by far, at about $410 billion, Indonesia's market capitalization is less than half that of Singapore and Thailand, and it is also lower than Malaysia's.

Although corporate earnings are rising rapidly, the market needs breadth, and more stocks to ensure supply can match potential demand.

Credit growth remains strong — Bank Indonesia expects loans to grow 26% this year — but equity markets' development is crucial for local firms to fund their long-term growth.

Between 2007 and the first half of 2012, 103 new listings in Indonesia raised $11.06 billion, according to Dealogic data. That is more than three times the amount raised by Philippine or Thai corporations during the period, but less than the $23.07 billion raised by Singaporean firms, and the $16.34 billion by Malaysian companies.

The country's market capitalization has jumped tenfold in as many years as more companies listed their shares. Although several well-established corporations remain unlisted, the market now reflects the economy more accurately than a few years ago. Unlisted firms include, among others, palm oil major Best Agro International and detergents maker Wings Group.

## Philippines

After a weak 2011, the situation is again looking rosy for the Philippines. The stock market is booming, growth has improved, and the mood generally is upbeat, not least because of the Standard & Poor's upgrade of the country's ratings in July to BB+ — just one step below investment grade.

The change of pace is a welcome development after GDP growth more than halved to 3.7% in 2011 from 2010, as Manila cut expenditures to try to reduce its budget deficit. In the second quarter, GDP rose a forecast-beating 5.9% from the year-ago period. The economy is expected to slow in coming months unless the government loosens its purse strings.

President Benigno Aquino has committed to lowering the deficit to 2% of GDP by 2013, from 3.9% when he took office two years ago. Although generally seen as prudent, some view such austerity as unwise for a developing nation with a desperate need to create more jobs.

With millions of young, educated and English-speaking workers, the Philippines is a perfect place to host the world's call centers. Philippines is the second youngest country in the ASEAN after Laos, with half the population under 23.1 years in 2012, according to CIA World Factbook estimates.

Revenue from the industry, which employs almost 650,000, accounts for about 5% of GDP. At the current annual growth rate of about 25%, analysts estimate industry revenues will top remittances within five years. Remittances from overseas workers make up about 9% of GDP.

Still, some point to the need to diversify such as it needs employment generating manufacturing as low commodity prices are good for the country, a net importer of resources including crude oil, and is another reason behind the brokerage's positive view on Philippines against the backdrop of weakening Chinese appetite for materials.

## Wanted skilled entrepreneurs to avoid 'demographic disaster'

As Indonesia faces the need to diversify its economy away from agriculture and mining, one crucial resource it is missing is hungry entrepreneurs.

That is a bit of an irony for a country dotted with tens of millions of small and micro enterprises that employ more than 60% of its workforce. But neither the firms nor the nation gets much benefit from the implied strength of those numbers. And that highlights a desperate need to empower entrepreneurs and reform the country's regulatory structure.

Most of the country's micro enterprises, which fall into a so-called "informal sector" outside the government's reach, are run by people who lack the resources and the skill to manage growth, improve productivity, or compete on a wider basis. In an atmosphere where the "formal" economy doesn't provide enough jobs, those employed informally typically earn less than $2 a day.

Entrepreneurship is alive and well, but there are challenges, such as a difficult regulatory environment and a relatively low quality labor force with inadequate education and vocational training.

Access to finance is also a big issue…the Indonesian economy is less banked and less monetized for an economy its size.

The informal sector, a common feature of many emerging economies, comprises firms that skip registration, don't pay taxes and aren't usually overseen by a government authority. Despite strength in numbers, the companies' contribution to national output and productivity is smaller than the formal sector's, according to the ADB.

The government also loses out on potential tax collections. In 2010, Indonesia's tax-to-GDP ratio was 10.89%, substantially lower than the 12.15%-15.97% range for neighbors Malaysia, Philippines, Singapore, Thailand and Laos, according to World Bank data.

## Ambition and fear

Fear of failure, and the absence of a burning desire for achievement, is partly to blame, critics say.

Although Indonesia is blessed with a lot of natural resources, they can't last forever, and the prospect of a "demographic disaster" is real unless the country generates and provides jobs to its millions of very young people.

About half of Indonesia's population is younger than 28.5, according to CIA World Factbook estimates.

## FDI and industry

While the government is aware of the acute need to nurture entrepreneurs, and has been promoting manufacturing and knowledge-based industries, the path ahead is difficult, say experts.

The government is starting to promote technology and creative industries through such initiatives as technology parks. The challenge for technology start-ups is in finding customers beyond the government.

The local market for technology products will need to develop, and exporting will be difficult with little experience and reputation in cross-border trade in technology products.

ADB economist Ginting said a large number of domestic firms aren't export-oriented, and fall outside a global "production network," due to inadequate foreign direct investment in the country until recently.

Moreover, Indonesia has attracted FDI only in the last three years. Data showed venture capital investments in Indonesia were significantly lower than in emerging markets such as China and India, as well as developed economies such as Singapore.

## Access to finance

The huge size of the informal sector and the small scale of microenterprises have helped create a thriving microfinance industry in Indonesia.

Microfinance, defined as loans of less than 50 million rupiah ($5,319), is by its very nature an expensive source of funding, as lenders price their loans to capture the high risks and costs involved.

Bank Rakyat, the country's largest microfinance provider and second-largest bank by total assets, charges interest rates of between 24% and 27% on such loans. The segment is a key driver of its high net interest rate margin, which is between 8% and 9% on all types of loans — a level that towers above interest rate spreads for banks in the West, or developing nations like China and India.

Citing government data, which puts the number of entrepreneurs in Indonesia as high as 55 million, bank officials said the potential for growth in this segment is huge, as only about a third of all micro-businesses in the country took a bank loan. The rest borrowed from other sources, including loan sharks, who charge up to 60% a year in certain cases, they added.

One reason cited for the high rates on microfinance loans is the high cost involved, as banks have to hire more loan officers and create a physical presence in far-flung places where borrowers reside and work.

Still, rates have been dropping with increasing competition.

### Philippines : Tourism key to unlocking the future

Fueled by remittances from a huge global diaspora of domestic workers and earnings from a swelling army of service workers onshore, growth is expected to hit 4.2% this year, according to International Monetary Fund estimates. To sustain its trajectory, the Philippines needs to not only get more value out of existing industries, but also forge new ones.

Tourism, which would highlight the Filipino attitude and drive infrastructure development, is the perfect fit, observers say. The Philippines is ideally suited to become a tourist mecca, but a lack of infrastructure and a history of corruption has held it back. The country has the tools it needs to fix this, with an expanding workforce, improving financial position and a government pushing hard to clean up corruption.

The Philippines needs to have other pillars to rely on including tourism, which hasn't been exploited at all.

The Philippines government wants to boost annual international arrivals to 10 million by 2016, from 3 million today. A bigger tourism sector would help absorb labor in its swelling population, as it nears 100 million. Rapid population growth has not been matched by infrastructure expansion. Aging roads and inadequate airports have frustrated economic development and made getting around difficult for visitors. There is a shortage of hotel rooms. The problems are curtailing the growth of what many see as the critical next-wave industry.

Since the 1990s, infrastructure spending in the Philippines has averaged around 1.8% of gross domestic product — well below the regional average and the World Bank's target of 5%. The government is trying to tackle this deficit with a slate of public-private partnership (PPP) infrastructure works. School, roadway and airport upgrades are on the agenda. Still, critics say the program fails to address the large-scale infrastructure black spots essential to fuel longer term economic growth.

Infrastructure development would achieve two aims — clear the bottlenecks and prove to the world that the Philippines can deliver. Execution so far has been slow. The need to ensure transparency and guard against corruption has impeded the pace of the PPP rollout.

### Mining

Beyond tourism, mining is another potential growth driver for the Philippines. The country is rich in minerals including copper, gold and nickel, but development of the mining industry has been stalled by political resistance and layers of red tape. Those obstacles are likely to push the meaningful development of the country's mining sector out by at least 5 to 10 years.

There are huge assets there to be tapped, and huge resources that are under-tapped for political reasons and due to resistance from local government.

Regardless of which industries the Philippines seeks to develop, international backing will be crucial.

Elections are also forthcoming and many are asking whether the foundation has been set by Aquino, and if it will continue to be supported in three years' time.

But with low debt and a government working hard to get its financial position in order, the Philippines represents the opposite of Europe. The nation boasts one of Asia's best performing stock markets. After a series of credit rating upgrades, it sits on the cusp of investment grade.

## Myanmar : Oil, Gas… And The Riches That Follow!

Myanmar, it may surprise you to know, is an old producer. It exported its first barrels before Lincoln was president, back in 1853. As late as 1941, Myanmar was the 14th largest oil-producing country in the world.

It's hard to know how much oil and gas Myanmar holds. Myanmar is a proven oil province but very much unexplored. There are 17 sedimentary basins, 14 onshore. Estimates for how much oil and gas might be here vary all over the map. Let's just say it's a lot. And knowing how these things tend to work, whatever estimates come out now will surely prove too low.

This is yet another spear that pierces the oft-repeated idea that somehow we're reaching a peak in oil production anytime soon. Here in Asia is another yet vast untapped oil province to add to the growing list of new potential supplies to come online in the next few years.

In any event, Myanmar has many of the oil majors salivating at getting a crack at Asia's last big frontier. It also has attracted the attention, of course, of the oil-needy Chinese. Currently, most of China's oil comes to China through the Strait of Malacca. This is one of the most important shipping lanes in the world. It handles an estimated one-quarter of the world's traded goods — including oil. The problem for the Chinese is that the U.S. Navy controls the strait. They have long sought an alternative route.

### Myanmar (or Burma) is that route.

There is a major transportation hub under construction now at the southern city of Dawei in Myanmar. The centerpiece is a deep-water port. *Once completed, the port will have a capacity to rival that of Singapore.*

Transporting goods through Dawei instead of the strait will lead to dramatic cost savings and reduced shipping times. It will also provide, via pipelines, a land bridge to China that skirts the strait. The Dawei hub will not only connect with China, but also Thailand, Cambodia and Vietnam. Already, Myanmar supplies Thailand with about 25% its natural gas; Thailand relies on natural gas for 70% of its energy needs.

thinking about the effects of all that money sloshing around. Oil and gas companies will bring billions of dollars of investment money into Myanmar. They will bring armies of workers. They will need housing. They will need food. They'll want restaurants and medical care and wireless connections. The oil companies will hire thousands of locals. They'll have more money in their pockets for groceries and clothes and nights out.

focus on "fast-growing sectors more likely to be free of cronyism, corruption and political baggage," as an AP story put it. These include technology and telecom, as well as real estate and financial services.

## Investments : Global investors key into Indonesia, Philippines and Myanmar

Trouble in Europe and lackluster growth elsewhere has brought the Southeast Asian equity markets of Indonesia and the Philippines closer to the global investment community and, while there are good reasons to consider both markets, there are also potential pitfalls for the unwary.

These markets have been a popular choice for investors since 2009 and have extended a solid upward run with sharp gains so far this year.

Signaling the strength of foreign investor interest in both the Philippines and Indonesia, new products have been developed to provide overseas investors with more options to access those markets.

U.S. exchange-traded fund giant iShares, managed by BlackRock Inc. , launched U.S. traded ETF funds for both Indonesia and the Philippines in 2010 — the iShares MSCI Philippines Investable Market Index and the iShares MSCI Indonesia Investable Market Index.

A lot more mutual funds offer access to these markets, according to FactSet. One such fund is a closed-end fund — the New York-listed Aberdeen Indonesia Fund which has bought into Indonesian companies to capitalize on an economy where incomes are rising and the nearly 250-million population is young.

Aberdeen likes to invest in companies with strong balance sheets and a prominent sector position, Reeves said, and named personal-care firm Unilever Indonesia Ltd. , owned by Anglo-Dutch consumer-products giant Unilever PLC, as an example of one such firm.

Foreign ownership addresses a key concern for the fund manager — that of corporate governance. Developed-market investors need to keep in mind that the level of corporate-governance protection of minority shareholders probably won't be what they are used to.

Jardine Cycle & Carriage Ltd , Holcim Indonesia and Bank OCBC NISP are companies that have quality management and protection for minority investors.

There’s been an effort to clean up corruption lately, and relatively low labor costs mean that Indonesia is attractive for multinationals seeking a cheaper manufacturing location than, for example, China.

Still, infrastructure development has been lacking, he said.This is a headwind for companies in many different ways. Distribution costs can be high as the roads are not very good, for example.

Indonesia is also a resource-rich country and some companies are focused on extracting commodities, which hasn’t benefited their share prices in a year where commodity prices have suffered amid concerns about global growth.

The Philippines, in contrast, doesn’t have the same exposure to the global trade cycle though commodity prices.

The country became an investor favorite as it suddenly had some very positive surprises such as progress on public-private partnerships and so there was more investment into the economy.

Real-estate companies have put in some of the best performances so far this year, with shopping mall developer Robinsons Land Corp. up 63% and residential and commercial developer Ayala Land Corp. up 48%.

Condominium builder DMCI Holdings Inc. has jumped 37% while banks have also gained, with Metropolitan Bank & Trust Co. up 37% and Bank of the Philippine Islands up 33%.

At the same time, the Philippines market isn’t cheap, with valuations at relatively rich levels compared with some other equity markets in Asia.

Both the Philippine and Indonesian markets are also on the small side for global investors. Compared with the NYSE Euronext exchange, which had a market capitalization of $11.8 trillion at the end of 2011, the market capitalization of the Indonesian stock exchange totaled $390.1 billion while the Philippines stock exchange’s market capitalization totaled $165.2 billion, according to data from the World Federation of Exchanges.

Any concern about the small size of the Indonesian and Philippines markets has been put aside in the past few years by investors in part seeking safety from European debt turmoil by buying into stable stocks and stable markets. However, size and limited market depth likely limit the appeal of these markets to the biggest investors who have to look at their exit strategy and so are unlikely to invest large amounts of money in markets that they would find comparatively difficult to leave.