The Ageing Economy

The population of Planet Earth now stands at a little over 7 billion. Whilst the Earth's population continues to grow, more striking is the rate at which it is growing significantly older. We have decided to write about investing in ageing markets this month as we feel there are some clear long-term investible trends within the sphere of ageing populations. The demographic trends vary across countries but in Emerging Markets generally it is the 45-65 year old bracket that will grow significantly in the coming years. Those in this age bracket are typically referred to as "empty nesters": They will have the largest income thresholds combined with an ever-reducing dependency ratio. The antithesis of this wealth effect is a high dependency, high birth-rate population, where typically consumer staple volume growth will underpin corporate profits. The empty nester category offers opportunities for higher margin and higher quality growth than that found in the traditional staples sector. We see their demands increasingly focused on luxury goods, tourism, life insurance, saving and investment products, pharmaceutical and private hospitals, and other discretionaries like home improvement and the eye care market being just some of the key beneficiaries.

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Perhaps the most obvious beneficiary of an ageing population will be the savings and investment industry. We see a strong growth period for bank non-interest income as well as for life insurance products. As an indicator of the potential in the industry, life insurance premiums represent 15% of GDP in the UK versus just 1.85% in Indonesia. With such low penetration and the basic demographics supporting the sector we see above-normal growth in the Indonesian life insurance market over the coming decade. This is a similar case across much of Asia. This trend is transforming emerging market banking systems that have been hitherto been driven fundamentally by loan growth and strong net interest margins. As the banks increase their non-interest income through bundling savings and investment products to their clients they can absorb compression of net interest margins and still experience growth. The switch from interest based income to recurring fee income will reduce the impact of global credit volatility on banking profitability. Further, the capital requirement for regular fee income is far less onerous than for heavy loan growth strategies, making banking systems far more efficient. With this backdrop we see NIM's falling over time in emerging market banks. Banks that have a large middle class focus and strong fee income strategies stand to benefit most. Insurance is an industry that should see multiyear growth and benefit from the movement to more complex life insurance products from basic savings products that dominate the market today.

The falling dependency ratios associated with ageing populations will result in a freeing up of disposable income, which should translate into increasing spend on discretionary products. This can be across many sectors but in particular

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we see growth for home improvement retailers as empty nesters spend on upgrading their homes. This has led to growing demand for DIY hardware, kitchens, ceramic tiles, white goods and general furniture. There has been a supply side response with most DIY retailers expanding rapidly, however we feel their growth will be at the expense of local "mom and pop" retailers as modern retail replaces the inefficient general retail model. Ikea has opened their first branches in Indonesia and South Korea this year while companies like Homepro of Thailand are targeting regional expansion following strong domestic demand.

Another inevitability of increasing population age is an increasing burden on healthcare systems and demand for medical care. Between 2002 and 2010 it is estimated that China's city dweller healthcare spending more than doubled, supported by wealth and demographic trends which we feel are now present across Asia. We are starting to see improvements in healthcare systems throughout emerging markets as governments expand their social welfare platforms. Malaysia and Thailand have broad healthcare systems already implemented while China now boasts of 97% healthcare coverage. The Philippines is rapidly expanding its health insurance market while last year Indonesia introduced the world's largest universal health insurance program which we think will start a new capex cycle in both the private and public healthcare in the country. The system will be funded by compulsory monthly payments however the government will fund the program for 85 million of the country's poorest people. The need for supply side growth is substantial with only 9 hospital beds per 10,000 people in Indonesia versus 29 in the US and the USA. Demand by public hospitals for generic drugs should see a surge helping local generic producers. Domestic generic drug producers do well in may cases where government license agreements make it difficult for overseas companies to access the market. Equally health care products such as vitamins, supplements and lotions will support growth of consumer lifestyle sales. In the hospital space, Thailand, Singapore and Malaysian hospitals have benefited from medical tourism amid the absence of high level care in neighbouring countries. Finally, ageing populations also imply increased demand for nursing homes and funeral parlours. Upon listing last

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year in Hong Kong, China's Fu Shou Yuan estimated that 180mn of China's 1.4bn people were over the age of 60. It is one of the few mathematical certainties that demand for funeral plots and columbariums will increase based on previous population growth.

We feel the spectacle and contact lens markets across Asia should see strong growth, supported by demographic trends and also income growth. In China the demand for spectacles is expected to see +20% per growth as the market for mid to high end spectacles sees the sweet spot for growth. Essilor, the world's largest lens manufacturer cited a population of 570mn people in China with requirements for reading glasses by 2020. Currently China spends $4 per capita on corrective lenses while USA spends $30. We feel that 45-65 age bracket is the largest growing pool of China's population but also the one that can more easily bridge

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the spending gap on a per capita basis. Hence we see strong average selling price and volume growth for mid to high end lenses in China over the coming decade. The same forces should support the contact lens market. The prevalence of myopia is about 30 to 40 percent among adults in Europe and the United States, and up to 80 percent or higher of 18 year olds in the Asian population, especially in China. In particular a lack of outdoor activities and extensive studying is seen as a major cause of myopia among Asian teenagers. Currently 6% of the Chinese population use contact lenses versus 23-25% in developed Asian countries. An observable trend within the contact lens industry is a shift from long-term wear lenses towards dailies as per capita income rises. In Japan 41% of contact lenses sold are dailies, while in China the figure is less than 25% with demographic differences between the two countries supporting a much higher percentage in China "daily" sales in the future. There is also a popular fashion for coloured and patterned lenses, especially amongst youth. Whilst the contact lens market is driven slightly by the younger population the trend is largely the same. The fundamental drivers of success in the industry will relate to distribution, brand recognition and working capital management as well as a continuous relationship with the vendors.

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