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Beyond Bulls & Bears

Exporting the "Bacon Genie" and Other Reasons to Be Bullish

July 2, 2015

From "Bacon Genies" to "Snuggies," there's little doubting Americans have a thirst for consumer goods, even those that don't always appear to serve much practical purpose. Brooks Ritchey, Senior Managing Director at K2 Advisors®, Franklin Templeton Solutions®, explores how an evolving consumer culture is spreading throughout the globe, and how he and his team are positioning their portfolios with these types of macro considerations in mind.

Americans are the world heavyweight champions of consumption—to a fault. If one doubts the validity of this assertion, may I suggest spending a few hours perusing the pages of any in-flight shopping magazine? The variety of "unique" gems that have apparently found a market in the land of Uncle Sam include the Snuggie for dogs, Bacon Genie, "Day of the Week Clock" (yes, it exists), a "PetSweep animal-powered debris removal system" with “one-size fits most paws” booties and, of course, the practical “ShoesUnder” bed box (didn’t the shoes come in a box?), “designed to keep your shoes dust, moisture and bug free.” At long last, a product for those pesky shoe bugs. Hooray!

Clearly, the United States has mastered the art of conspicuous consumption—but what about the rest of the world? According to the United Nations, Asia (ex-Japan) represents 45% of the world’s population,[1] yet the region consumes less than half that of the United States despite having 10 times the people! Said differently, there are still 3 billion potential new consumers who have joined the global marketplace over the last several decades and have yet to fully participate in it. Intuitively, the East’s lack of shopping stamina is a function of many factors, including cultural, social, economic and demographic characteristics. From an ideological/philosophical standpoint, the enlightened mind that recognizes happiness and fulfillment are states of being to be achieved without material excess is, of course, a good thing; I wish to be clear on that. I am not suggesting Asia needs to “Keep Up with the Kardashians,” so to speak. That said, I do believe there are aspects of Western consumerism that would benefit the emerging economies, were they to embrace it, and would also benefit the global economy as well. The good news is there are both structural and cultural shifts emerging that we believe will allow this to happen.

As the Disney song and theme park attraction of the same name suggests it is, indeed, a small world, and getting smaller each day in terms of the landscape against which investment decisions are made. Markets have never operated in a vacuum—save for the theoretical playgrounds of academia—and exogenous factors have always played a part in outcomes. More recently, however, it seems the influence and intensity of those global factors—such as socioeconomic shifts in emerging market regions of the world—are more pronounced. Even the most casual observer of Wall Street can bear witness to this reality.

A Global Rebalancing

Economic/structural and social tectonic plates are shifting, reflecting a paradigm change that we believe is likely necessary if we desire sustainable growth in the future. Structurally, significant trends in spending power across the major emerging (or rapid) growth markets are visible. According to Ernst & Young, in less than a decade there will be 200 million emerging market households with annual incomes exceeding US$35,000.[2] This represents a dramatic change. In China alone, the number of households earning this amount is projected to triple to almost 80 million by 2022. In addition, Brazil and Russia will each be home to 15 million such households, while Mexico, Turkey and India will each have more than 10 million.[3] Together, the middle classes of these rapidly growing markets are projected to surpass that of the United States in less than 10 years, and by a meaningful margin.

Given this possibility, it appears that at least from a structural standpoint the East stands ready to take up a portion of the West's shopping club mantle. It suggests that Asian and other emerging markets will increasingly look to their own populations to drive demand, with the growing middle class buying a wider range of goods and services. Bacon Genie, anyone?

Cultural Changes

Second, and perhaps more importantly, cultural attitudes about consumption appear to be shifting, perhaps for the better both in the East and West. That is to say popular behavior in emerging/Asian economies is moving toward consuming more and conserving less, while in the West attitudes seem to be moving in the opposite direction, toward a more conservationist, "mindful" and minimalist state (though perhaps not quickly enough to some observers).

In other words, there are signs that the world is moving toward more consumption uniformity, and that the disparity between the West and Asia is narrowing.

Looking more closely at China in particular, there seems to be a willingness among the population to adopt more Western-centric behavior in terms of purchasing habits. Anecdotally, an article in *Bloomberg Markets* magazine [4] told the story of a Chinese grandmother pacing the aisles of an IKEA store in Beijing, looking for a small bed with toys for her grandson. The woman was not looking to purchase the bed, however, but rather simply seeking a place for the 1-year-old child to take a nap. Curious? Not really, when, according to the article, on any given Saturday afternoon every bed in the 43,000-square-meter Beijing home furnishings store is occupied, with both children and adults fast asleep under the covers. For many Chinese, visiting the IKEA store is not necessarily about buying as much as it is about the experience (like Westerners visiting Walt Disney World's Epcot). IKEA naturally welcomes the trend, as the more Chinese residents visit the store, the more likely it is they will consider IKEA when the time comes to actually purchase a new sofa. Given the projected growth in disposable income for the average Chinese citizen, that time appears to be quickly approaching.

In addition, the current teenage population in China was born after the Tiananmen Square incident (in 1989), coming of age in a time of economic expansion and prosperity. As such, they likely have very different attitudes about spending than their parents. For example, Chinese adolescents are surprisingly heavy users of technology, particularly given current income levels. A study by the Boston Consulting Group found that the Chinese spent more time online than people in any other large developing country.[5] The study also found that in rural China nearly half of all Internet users were under 20, while 80% were under 30.[6]

Furthermore, the Chinese government has also embraced the idea of stimulating internal consumption, cultivating a more capitalist sentiment among its population with the intent of ultimately building a more sustainable economy. Chinese leaders have called this initiative the "balanced and harmonious society," where citizens can afford more comforts of modern life, better housing, clothing and technology. The Chinese government is very aware of its country's changing demographic landscape, and the eventual need to rely more on internal consumption for future growth. Fewer new workers are expected to enter the labor pool (one-third fewer 16- to 24-year-olds over the next 12 years) while more senior citizens are projected to exit.[7]

In short, China's position in the world as the assembler of choice based on the cheapest and most reliable labor force is gradually changing. It seems inevitable to us that China will be forced to make the transition from manufacturing economy to innovation economy, from a net exporter to a net buyer.

We believe this shift is a good thing, because for the rest of the world the Chinese consumer is one of the best hopes for future prosperity. In the years ahead, if the United States, Europe and Japan have no choice but to slow spending and tighten belts, China will hopefully be in a position to take the lead on spending.

Indeed, millions of Americans could end up with jobs that exist, at least in part, to design, make or sell goods and services to China.

The Rebalance and Global Investing

For many emerging countries, transitioning to a service economy from an industrialized one will be difficult, certainly more challenging than that of moving from agrarian to industrial. The farmer can be moved into the city only once. Beyond that, emerging economies will need to manufacture goods that are not only cheaper than the competition, but better as well. The idea is to cultivate a healthy domestic consumption market, so that its own consumers can pick up the slack when exports inevitably slow.

Again, looking at China as a proxy, many Westerners who visit the country are awed by its accomplishments and explosive growth. Cities have sprouted from nothing, rural highways are smoother than many airport runways in the West, and bullet trains can cover the distance between New York and Washington in one hour. The United States is on course to have such trains, hmm, maybe never. Even for those who have not physically visited China, one need only recall the television broadcasts depicting the spectacle and wonder that was the Beijing Olympics to appreciate the extent of China's dramatic potential change.

Nonetheless, the question remains, can an economy growing as rapidly as China's backfill the framework of its economic infrastructure with the mortar necessary for it to self-sustain? In other words, will wages rise fast enough, consumption expand and entrepreneurial innovation flourish? We shall see.

The Bottom Line

The global economy is at a crossroad of sorts, facing a paradigm shift that is necessary for sustainable growth in the future. In our view, modifications in policy and consumer behavior will be requisite in both developed and emerging nations. In Asia in particular, a pattern change in cultural thinking and behavior is evolving.

I believe nearly everyone would agree these trends are for the better—better for humanity and populations in the less prosperous parts of the world, better for the strength and sustainability of the global economy as a whole, and—as fate would have it—better for creating opportunities in global investing as well. And last but not least, better for bacon?

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1. Source: United Nations, "State of World Population 2011."

2. Source: Ernst & Young, "Growing Beyond: Rapid-Growth Markets," February 2014.

3. Ibid.

4. Source: Bloomberg, "In IKEA's China Stores, Loitering is Encouraged," October 28, 2010.

5. Source: Boston Consulting Group, "The Digital Chinese Consumer in a Multichannel World," April 2014.

6. Ibid.

7. Source: Emerging Market Investment Perspectives: Morgan Stanley, March 11, 2010.

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