Equity Themes for a Global Economy
Or
Breaking loose from the Tyranny of the 'Indexers'

The current fashion for 'index-tracking' as the preferred, low cost method of equity management means than many readers of this article may already have investments linked directly to returns from the FT100 index (either in their own name or more likely through the company pension scheme). What was probably not explained to them when they made the investment was the underlying 'industry allocation' of the companies that make up the index. For example the FT100 has more direct exposure to the assets of pub & brewery stocks than to the world's fastest growing industry, information technology. It also includes three of the largest companies in Asia (Cable & Wireless, HSBC and Standard & Chartered) and soon three of largest companies in South Africa, but no global company with a pure exposure to the Internet. These are just a few of the geographic anomalies that are beginning to make investors question whether country based equity allocation really is the best way to manage money in today's global economy.

One of the ways to address these questions is to adopt a 'theme driven' approach to equity selection. This is based on the simple belief that growth in the world economy is now based less on the prospects for individual countries and more on the development of wider global themes that operate right across national boundaries. These themes could be the result of new technologies, changing world economics or business practises, or indeed specific 'one-off' events like the emergence of the Euro, which already has altered so much of Europe's business landscape.

Such 'Super Themes' are not new; the growth of railways in the 19th Century and the telephone in the 20th Century, or indeed the development of the emerging economies in the mid-1980's are all examples. The last few years though have some particular significant examples including the effects of privatisation and deregulation, an explosion in international trade, and a revolution in communications and information technology.

Within these trends national politics, economics and labour conditions remain important but it is increasingly difficult to argue that their impact is now the dominant influence on either world growth or corporate profitability. While such changes may be simple facts of life for most international businessmen they are still surprisingly revolutionary for the traditional fund manager. In a global economy does it really make more sense to move equity assets from Tokyo to Toronto, or is it more logical to move assets **from** companies that will be

vulnerable to competitive pressures of Electronic-Commerce **to** those that will enjoy sustainable global pricing power?

One particular example is the extra-ordinary growth of *Corporate Restructuring* as an investment influence right across the industrialised world. The concept of a new generation of managers restructuring companies to boost shareholder value, setting demanding returns on capital employed, retiring equity and re-focusing on their core business was first prominent in the US more than ten years ago. It was seen in the UK in the early 1990's and more recently has appeared as one of the driving forces behind the spectacular gains seen in European equity prices. The nature of restructuring itself changes - only two years ago European management was preoccupied with cost cutting and rationalisation in large industrial groups, now we have seen this move on into a surge in M&A activity (over $500bn in 1998). Today the unprecedented contested acquisitions of Societe Generale and Paribas in France, and Gucci and Telecom Italia in Italy would, if successful mean Europe seeing a greater volume of hostile bid activity in a few months than it witnessed over all the preceding 10 years!

Perhaps most exciting of all is that this new 'Shareholder First' philosophy is now appearing in Japan and parts of Asia. Corporate restructuring programmes in Korea, share re-purchase programmes and management incentive plans across 'Blue-Chip' Japan (i.e. Sony's radical cost control and rationalisation programme) are just a taste of the rewards that may finally reward the long suffering Japanese shareholder.

A second global trend that is increasingly determining the profitability of companies, regardless of their geographic location, is the way they use information technology, and in particular the Internet. Already the cost of communicating with customers, the transparency of prices and the efficiency of the Net as a means of business are starting to become one of the most powerful determinants of future corporate profitability. Growth continues with the volume of Internet traffic roughly doubling every 100 days, and with data traffic on many Western telephone networks now easily exceeding voice. The number of potential on-line customers also continues to rise, with estimates now suggesting that more than 50% of US homes are 'wired,' while European and Asia are catching up far faster than many expected. In all about the same number of people link to the net each as read a US daily newspaper.

The impact of this surge in Internet usage extends much further than the pure technology sector. In the U.S. recent figures suggest that almost 20% of all stock trades are now conducted on-line with companies such as Charles Schwab (the leading on-line brokerage firm) now capitalised at substantially more than Merrill Lynch. Meanwhile in the UK

Prudential's Egg electronic banking division has already attracted over 500,000 customers and almost 20% of all new UK private deposits in just 6 months. With analysts now suggesting that an on-line mortgage has just 10% of the sales costs of the equivalent branch based transaction, the phenomenal opportunities for competitive pricing that E-Commerce will unleash are readily apparent.

E-Commerce and Corporate Restructuring are just two of today's leading investment themes but already they form an indispensable part of any truly global equity portfolio. But finding the companies that will be the winners from these trends is remarkably difficult if you are still using just country based analysis, because the underlying concepts themselves show little respect for any national or regional boundaries.

So today's global investors will have to use a new sort of investment technique or risk missing out on even more of the long-term trends that will drive world growth in the new Millennium. Either they can chose a series of long-term investment themes themselves (and then pick individual funds or stocks to match) or else they can buy one of the growing number of 'multi-theme' funds now available, to do the job for them. These funds follow several global investment themes simultaneously, just like traditional managers track markets, actively allocating assets between them, regardless of the geographic distribution that results.

This sort of solution might still sound radical to most UK investors, but for an American it is clearly the historic norm. After all few US investors held Microsoft stock just because Bill Gate's head office is in Washington State, they bought it because the Company holds an utterly dominant share of PC operating systems world-wide. So isn't it time then that our 'Indexers & Trackers' also started looking a little further than the location of the Chairman's office, as the sole means of setting their global equity selection?

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