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Research:
Global Investment Themes – A treatise

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We present to you a series of reports on some of the investment themes that we opine are going to impact the investment landscape globally, therefore determining the course of action for Markaz International Investments. For a start, this report takes you through the different themes and their relevance in the current market conditions globally.

Commodities – Agriculture

Our outlook for agriculture products and food prices is bullish for the next three to five years, driven by rising developing world incomes, high oil prices, demand for biofuels, political interference, population growth and low inventory levels. There are potential new sources of supply in the long run from large existing areas of farmland and improving crop yields. However, such supply would necessitate investment and time – at least two to three years – meaning the level of agricultural prices is likely to remain higher for longer.
Also, structural changes such as increased demand for feedstock, biofuel production, and the reduction of surpluses due to past policy reforms, may keep prices above historic levels in the longer term.

Consumption annual growth rates, 2007-16E

	Consumption (%)		
	Total	OECD	Non-OECD
Wheat	0.8	0.9	0.8
Rice	0.9	0.1	1
Coarse grains	1.2	0.9	1.5
Oilseeds	1.9	1.3	2.2
Oilseed meal	2.1	0.9	3.2
Beef	1.5	0.2	2.4
Pig meat	1.7	0.5	2.2
Poultry meat	1.9	1.1	2.4
Butter	2.3	0	3.4
Cheese	1.3	1.1	2
Skim milk powder	1.1	1	1.3
Whole milk powder	2.5	1	2.8
Vegetable oils	2.5	2.4	2.6
Sugar	1.8	0.5	2.2

Source: FAO

Global economic growth is propelled mainly by fast growing economies of large developing countries. In particular, the emerging economies of China, India, Brazil and Russia are key to global and agricultural market developments. Over the next 10 years, the countries in the non-OECD region are expected to continue to experience a much stronger increase in consumption of agricultural products than countries in the OECD area. The strong growth in demand in many developing and emerging economies is also expected to spur expansion in imports and provide the impetus to the development of domestic production capacity. These developments taken together lead to the projection of lower consumption growth prospects in the OECD region than in the developing and former transition countries for all of the agricultural commodities listed in the table above, but wheat.

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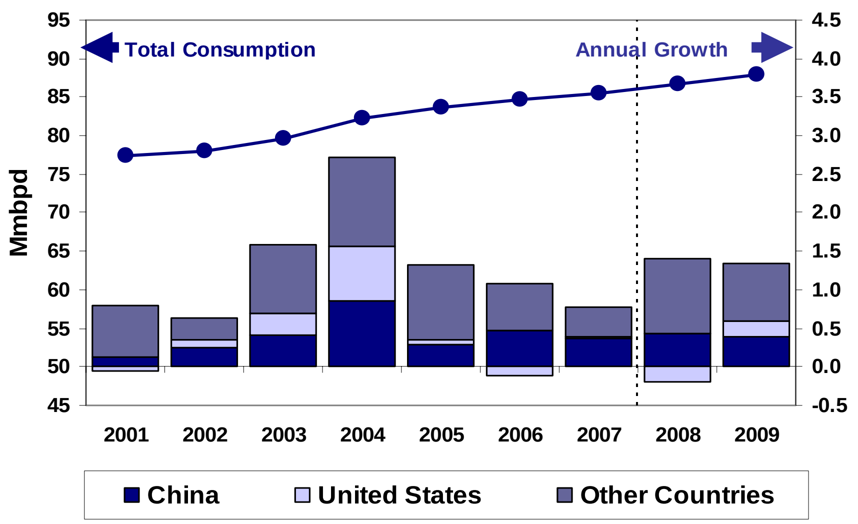
Growing use of cereals, sugar, oilseeds and vegetable oils to satisfy the needs of a rapidly increasing biofuel industry is one of the main growth drivers in the next 3-5 years. To add, substantial amounts of maize in the US, wheat and rapeseed in the EU and sugar in Brazil will be used for ethanol and bio-diesel production. This is underpinning crop prices and, indirectly through higher feed costs, the prices for livestock products as well. For higher value agricultural commodities such as meat and dairy products, demand is more responsive to the rising incomes in emerging economies than it is in the mature markets of OECD countries.

Commodities – Oil, Basic Materials

One of the key commodities being much talked about is crude oil, which has witnessed prices skyrocketing in the last 10 months. The fact that crude oil is priced in US Dollars coupled with the dollar depreciation has made crude oil less expensive for consumers in non-dollar regions, thereby increasing their demand. On the supply side, price pressures arise from declining profits in local currency for producers outside the dollar area. This is a key theory behind oil price increases.

Added to this, in 2007, demand from non-OECD countries increased by an estimated 1.3mbd, whereas OECD demand declined by 0.1mbd. But the global oil supply could not match the pace, increasing only by 0.2mbd in 2007, reflecting a combination of slightly lower production by OPEC countries and shortfalls in non-OPEC production. Much of the growth in non-OECD economies occurs in non-OECD Asia, which includes China and India. In the last 2 years, China alone accounted for more than 30% of the world's incremental consumption of liquid fuels.

Oil Consumption



Source: EIA

Oil consumption in an economy is linked to the growth in the economy. Oil demand will continue to rise as economies grow and will indirectly put a pressure on oil supplies or alternative energy sources that might replace oil as the choice of energy medium. Our estimate of the correlation between growth and oil consumption is extremely high, varying between 0.8 and 1 for different countries.

Among the BRIC nations, Brazil and Russia are important players in the energy segment. With tax cuts for oil production now more likely, we are bullish on the Russian energy sector. Also, new oil field finds in Brazil can potentially put Brazil at the forefront as the strong exporter of oil.

Infrastructure-related commodity prices should remain supported by Asia's massive infrastructure spending. Asia Pacific Ex Japan has rapidly emerged as the largest consumer of infrastructure-related commodities in the world, including Cement (61% of the world), Steel (46%), and Coal (58%), mainly driven by China (39% in Cement, 31% in Steel & 39% in Coal). Asia Pacific Ex Japan's substantial capex in power transmission grids supports strong Copper demand. We believe that the production for these commodities continues to lag demand growth and thus, these supply-side issues become a key for high commodity prices to persist.

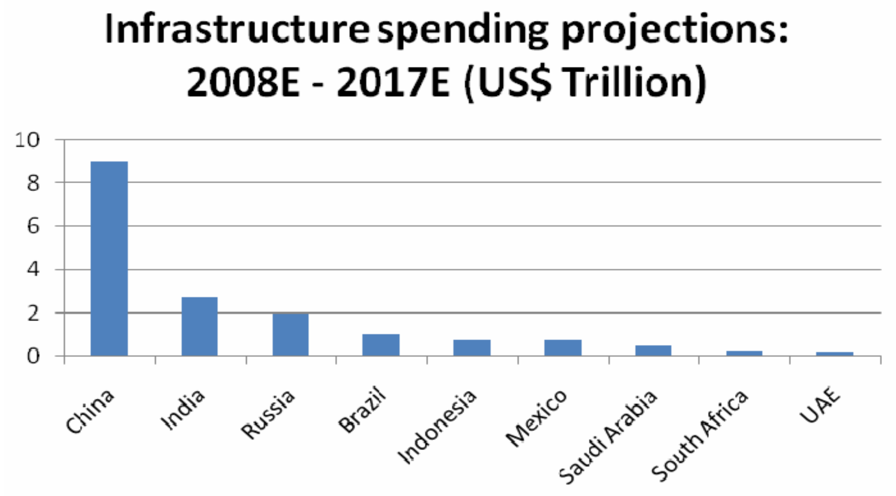
Infrastructure

Substantial Infrastructure Spending Ahead: Estimates reveal that infrastructure spending in emerging Asia will reach US$3.1 trillion over the next five years (2008-12E), about 6.2% of GDP. By comparison, annual spending in the US was just 1.7-2% of GDP over the past 10 years. Our preferred infrastructure sectors with high growth potential, but relatively low risks, include wind power, railways, select airports, water and energy E&P & oil-services.

The specific demand drivers, in our opinion, are robust economic and IP growth, rapid urbanisation, and rising income levels, which have increasingly stressed Asia's infrastructure system, driving demand for upgraded infrastructure. China has been well ahead of the curve among emerging markets, with investment at about 9% of GDP. India and Indonesia are expected to catch up. Besides, Asian Governments' budget deficits have narrowed substantially since the Asian Crisis, allowing a lift in infrastructure spending. Hong Kong, Singapore, Korea and China are particularly well-positioned in this regard.

Some developing countries, such as India, Brazil and China provide specific tax incentives designed to encourage private investment. In the developed economies, specific tax incentives for infrastructure (outside of the alternative energy sector) are somewhat limited. The US has traditionally encouraged infrastructure financing in the public sector via the favourable tax treatment of municipal bonds. It is also considering doling out incentives for private investment in infrastructure.

The World Bank estimates of infrastructure spend are more sanguine, anticipating a lot of thrust on unabated growth in infrastructure spend among the BRIC nations in the next ten years.



Source: World Bank

In Saudi Arabia, the authorities have ramped up spending on needed social and economic infrastructure. Total spending in the 2007 budget increased by 11 percent relative to 2006. Staff projections suggest that the 2008 budget outturn will be more expansionary. With domestic inflation pressures rising, it will be important to prioritize spending in areas such as infrastructure to help relieve supply bottlenecks.

The real estate sector in India today is undergoing significant changes making India a preferred destination for real estate activity. Given the growth in organized retail, and overall robust industrial growth, there is tremendous boom in need for organized warehousing in new emerging hub-spoke transport routes. Transport infrastructure such as multi-level car parks, bus terminals; and Industrial parks – Multilevel car parks and bus terminals in city centers that provide traffic relief to urban dwellers. Tax friendly structures coupled with high manufacturing and industrial growth has made industrial parks a high-return investment area.

While relatively self-sufficient in capital, China allowed private sector investment in infrastructure projects. It is likely that China will increasingly look to private investment. As with the US, the sheer size of the Chinese market means that even if private investment opportunities are limited when compared to other markets, they will be significant.

Partly because of a huge budget deficit, India has been spending a lower percentage of its GDP on infrastructure than China has, but it plans to accelerate its infrastructure spending, and it is looking at the private sector to provide much of the capital. This could create more opportunities for international investors to join with Indian partners in making direct investments in infrastructure in India or creating infrastructure funds.

Telecom – Emerging markets

We believe Telecom sector in Emerging markets has still a lot more to offer in terms of growth opportunities. 64% of mobile users are in Emerging markets. The number of GSM connections has surpassed 3-billion mark recently and a fairly large chunk of growth has come from Emerging markets. Despite the growth, markets like China and India have very low penetrations.

Subscriber statistics end Q4 2007	
By Technology	
GSM	2,685,060,046
3GSM (WCDMA)	196,063,100
CDMA	10,934,971
CDMA 1X	299,490,215
CDMA 1X EV-DO	89,728,932
TDMA	6,388,940
PDC	15,089,273
iDEN	27,425,216
Analog	1,050,740
World	**3,331,231,433**

GSM technologies by region		
Asia Pacific	**1,162,251,880**	**40%**
Europe: Western	478,833,084	17%
Europe: Eastern	397,925,950	14%
Americas	297,393,161	10%
Africa	265,076,453	9%
Middle East	173,200,146	6%
USA/Canada	106,442,472	4%
World	2,881,123,146	

GSM - Top 10 countries			
Total net additions:		**Total connections:**	
India	**25,305,201**	China	529,620,000
China	**23,925,000**	USA	252,072,378
Brazil	8,355,681	India	236,970,254
Indonesia	7,562,886	Russian Federation	172,498,347
Russian Federation	7,252,348	Brazil	122,301,331
Pakistan	6,422,383	Japan	100,525,400
USA	5,891,486	Germany	97,151,000
Iran	4,674,540	Indonesia	92,209,273
Nigeria	4,205,448	Italy	89,637,000
Mexico	4,144,991	Pakistan	76,431,388

Source: GSMA

The world's biggest GSM markets today are China (509 million), which is growing at a rate of more than 7 million new connections a month and accounts for 14% of the third billion growth; India (193 million), growing at 6 million per month accounts for 12% of the third billion growth, Russia (178 million) and Brazil (93 million) which both contributed 4% of the third billion growth. It is estimated that more than 1 billion phones will be sold this year. Fixedline, mobile and Internet subscribers in Asia Pacific Ex Japan significantly exceed those in the US. In 2007, mobile and fixed-line subscribers reached 1,081 and 571 million, respectively, while US mobile subscribers were 255 million. In fact, China on its own is the world's biggest market for fixed, mobile and Internet subscribers.

Consumer

Among the consumer segments, we are focused on auto and consumer finance as the potential growth segments for the next few years.

Auto: The auto segment in the emerging markets is an exciting story. China is witnessing stupendous growth; both the passenger segment and commercial vehicles segment are showing high growth. While passenger cars segment has been briskly growing at double-digit YoY growth rates, month after month, the commercial segment is showing robust growth on the back of strong trucks segment growth.

In India, overall Auto demand across segments posted stronger growth as recent demand stimulus from the government – reduction in excise duties, implementation of pay commission report and rationalization of personal income taxes gains traction. In Indian market, in the near term, we are bullish on Passenger cars. Commercial vehicles segment, however, remains tepid.

In Korea, the monthly domestic sales recovery is in an acceleration mode having caught up double-digit YoY growth momentum. Besides, a weaker Won should sustain exporter's earnings momentum. Pro-growth policy announcements and interest rate cuts could be further catalysts in this market.

Consumer Finance: In order to combat the rising inflation, although governments have sought to increase the key interest rates, thus retracting credit growth, we believe this is a short term glitch in slowing credit growth. Besides, our belief has always been that credit growth is highly correlated to the growth in the economy, and so emerging economies which are forecasted to witness brisk growth rates are potential target segments.

Brazil Retail sales data continue to be strong and this quarter as a whole, retail sales in 1Q08 were up 12.0%Y, accelerating from 9.6%Y in 4Q07. 1Q08 was also the strongest quarter (year on year) on record, since the start of the series in 2001. And it is the credit-related sectors that paved the way. For instance, sales of furniture and household appliances were up 14.3%Y in March while supermarket sales were up 8.5%Y.

In the United States and the euro area has remained robust thus far, whereas in Japan, the decline in credit growth began at end-2006 and predates the recent global turmoil. In the United States, credit growth spiked after August 2007, owing to a surge in commercial and industrial (C&I) loans, which reflected in part the disbursement of leveraged-buyout related credits that banks had underwritten before the financial market turmoil but were unable to syndicate or sell afterward. However, since then credit growth has declined, led by a noticeable decline in lending to the real estate sector, although it remains broadly in line with average growth rates observed during the past five years. At the same time, growth in bank security holdings has significantly increased, in part owing to banks' absorption of assets from off-balance-sheet entities back onto their balance sheets.