

Consumption Growth: Investing in Today's Emerging Markets



About Mirae Asset Global Investments

Mirae Asset Global Investments manages investment strategies for clients across the globe. With approximately \$70 billion in total assets under management (as of March 2015), and over 540 employees, including 124 dedicated investment professionals, Mirae Asset offers a breadth of emerging markets expertise. Mirae Asset's offices are located in Australia, Brazil, Canada, China, Colombia, Hong Kong, India, Korea, Taiwan, the U.K., the United States and Vietnam.

We focus on actively managed emerging market-focused portfolios through a bottom-up investment process rooted in on-the-ground research. Mirae Asset Global Investments is recognized as one of the world's largest emerging market equity investment managers* and has one of the largest teams of investment professionals dedicated to emerging markets. Our worldwide team of portfolio managers, analysts and strategists maintains proximity to the investment opportunities that we research, allowing a deep understanding of companies and the cultures in which they operate.

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*Source: *Investments & Pensions Europe*, January 2014

Introduction

OUR INTENT IS TO DEMONSTRATE HOW RISING NUMBERS OF CONSUMERS IN THE EMERGING MARKETS ARE SET TO TRANSFORM THE GLOBAL ECONOMIC LANDSCAPE OVER THE COMING DECADES, AND THAT THIS PRESENTS A UNIQUE INVESTMENT OPPORTUNITY.

Consumers in the U.S. and in other major developed economies have been a key source of global demand and an important driver of global growth over the last 50 years.¹ The headwinds these economies are currently facing though are putting into question whether they can continue to lead global growth as they have done historically. However, as the challenges in the developed world increase, the emerging world is exhibiting a range of conditions that we believe will likely drive global growth in the coming decades. We are all familiar with the Chinese growth story and the increasing popularity of the emerging markets with investors but the question we will seek to answer in this paper is; whether the rise of the emerging market consumer is a sustainable investment theme and where do the specific opportunities lie?

There is one statistic that we believe places into context the scale of the changes currently happening globally. Research reveals that the number of middle class consumers in emerging markets will reach 1.98 billion by 2020; this is compared to 77 million Baby Boomers in the U.S. — a generation widely acknowledged to have had a profound and lasting impact on both economic output and domestic consumption in the developed world.² In this white paper we will go beneath the surface to examine the drivers behind this emerging middle class and how increasing urbanization and positive demographics are all pointing to significant income growth potential.

We will also explore the impact this income growth will have on global consumption levels and spending patterns. According to

the McKinsey Global Institute, annual consumption in emerging markets will rise from \$12 trillion in 2010 to \$30 trillion by 2025 and during the same period, the emerging markets' share of world consumption will increase from 32% to 47%.³ As investors, we need to know who will be the winners from this exponential growth in consumption and what the key factors are when trying to understand an investment landscape that is fundamentally different to that which we have seen previously.

In this paper we will outline the fundamental pillars supporting the expansion of the middle class in the emerging markets and how this will translate into the emerging market consumer becoming the dominant force in the global economy in the coming decades.

There can be no guarantee that any strategy (risk management or otherwise) will be successful. All investing involves risk, including the potential loss of principal.

¹ Categorized by the International Monetary Fund (IMF), the major advanced economies (G7) comprise seven countries: Canada, France, Germany, Italy, Japan, the United Kingdom and the United States.

² US Census Bureau, and UN Department of Economic and Social Affairs; The Brookings Institution, "The Emerging Middle Class in Developing Countries". 2010.

³ McKinsey Global Institute, "Winning the 30 Trillion Decathlon," August 2012.

Four Factors of Consumption Growth

THERE ARE STRONG FUNDAMENTAL FACTORS SUPPORTING THE EXPANSION OF THE MIDDLE CLASS IN THE EMERGING MARKETS. THESE FACTORS ARE ENABLING THIS IMPORTANT AND GROWING SEGMENT OF THE POPULATION TO BECOME A DOMINANT FORCE IN THE GLOBAL ECONOMY IN THE COMING DECADES. WE BELIEVE THE FOUR KEY FACTORS SUPPORTING THIS TREND ARE 1) URBANIZATION; 2) INCOME GROWTH; 3) FAVORABLE DEMOGRAPHICS; AND 4) CONSUMPTION-LED ECONOMIC GROWTH.

Urbanization

Mirae Asset sees urbanization within emerging markets as one of the most important drivers of consumption growth. As people shift from rural areas to urban districts and seek new professions, higher wages and a better quality of life, they have access to a larger number of socio-economic opportunities. With greater job prospects and higher wages, the rural farmer becomes the new middle class consumer. According to the World Bank, middle class is defined as people earning between \$10 and \$50 per day (or \$3,520 to \$17,600 per annum), adjusted for purchasing power parity.

Historical data shows that the process of increasing urbanization significantly contributes toward economic growth. Every five-percentage-point increase in the share of citizens living in urban areas generates a 10% increase in per-capita economic activity.⁴ Countries with high urbanization levels have the highest per capita gross domestic product (GDP)⁵ and higher individual incomes in absolute terms relative to peers.⁶ Through the process of urbanization, cities increase their levels of economic activity which in turn results in greater consumption.

The current urbanization gap between emerging countries and developed countries is still sizable, but is declining. As the table shows, urbanization in developed countries was fairly saturated with 77.1% of the population living in cities as of 2010, and although the process of urbanization will continue to take place, it will occur at a slower pace. The United Nations projects that by 2050, the population living in cities in developed countries will reach 85.4%. In emerging economies, however, this trend is still in its nascent stage, with only 46.1% of the population living in cities as of 2010. The urban population in these emerging economies is expected to increase to 63.4% by 2050.

PERCENTAGE OF POPULATION RESIDING IN URBAN AREAS

MAJOR AREA OR COUNTRY	2010	2025	2050
Developed Countries	77.1	80.4	85.4
Germany	74.3	77.5	83.0
Japan	90.5	96.3	97.7
UK	81.3	84.8	88.6
US	80.8	83.3	87.4
Emerging Countries	46.1	54.0	63.4
Brazil	84.3	87.8	91.0
China	49.2	65.4	75.8
India	30.9	37.0	50.3
Indonesia	49.9	60.3	70.9
Mexico	77.8	81.8	86.4
South Africa	62.2	69.4	77.4
South Korea	81.9	83.8	87.6
Thailand	44.1	60.4	71.8
Turkey	70.7	77.7	83.7

Source : UN Department of Economic and Social Affairs, World Urbanization Prospects: The 2014 Revision

⁴ Credit Suisse, Emerging Market Research Institute, April 2012.

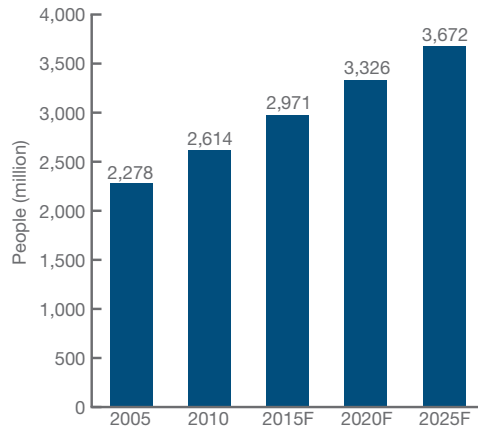
⁵ Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

⁶ UN-HABITAT, "Urban Trends: Urbanization and Economic Growth", March 2010.

In terms of total population numbers, the absolute number of city dwellers in emerging countries already far exceeds the urban population of developed countries — totaling 2.6 billion in 2010, or about 2.7 times larger than that of developed countries. According to the United Nations, the urban population in emerging markets is expected to rise to about 3.7 billion by 2025. By 2030, city populations in emerging markets are expected to reach 4.0 billion people, or about 4 times larger than those in developed countries.

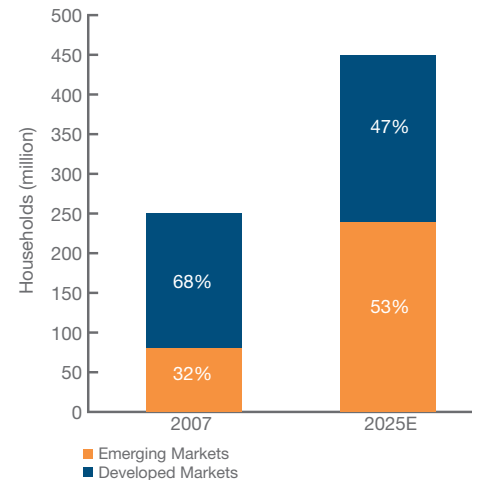
It is this growth in urbanization in the emerging markets that we believe is setting the stage for a multi-decade consumption boom. The global distribution of urban household wealth is already tilting towards the emerging markets, with consumer spending in emerging markets expected to grow three times faster than consumer spending in developed markets to reach a total of \$6 trillion by 2020.⁷ The process of urbanization that has historically driven the growth in the developed market economies is now happening in the emerging markets but on a far greater scale, creating a whole new class of consumer.

URBAN POPULATION OF EMERGING MARKETS



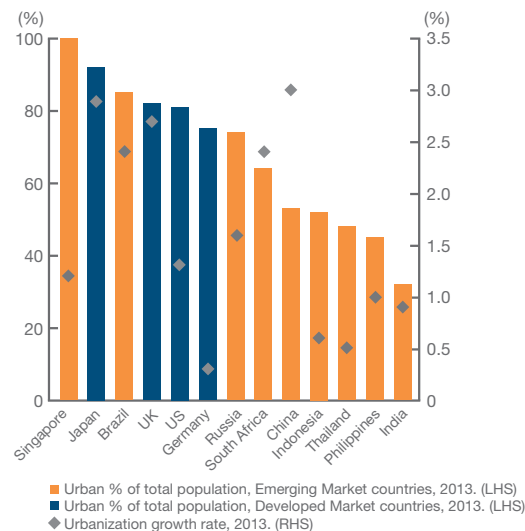
Source: United Nations, June 2014.

NUMBER OF URBAN HOUSEHOLDS WITH ANNUAL INCOMES > US\$20,000 IN PPP⁸ (PURCHASE POWER PARITY) TERMS



Source: McKinsey Global Institute, Morgan Stanley Research, October 2011.
E=McKinsey estimates

URBANIZATION RATES OF SELECT COUNTRIES (2013)



Source: World Bank, 2015.

Estimates and forecasts are only projections and not guarantees.

⁷ McKinsey & Company, 2012.

⁸ Purchasing Power Parity (PPP) is the rate at which the currency of one country would have to be converted into that of another country to buy the same amount of goods and services in each country.

Income Growth

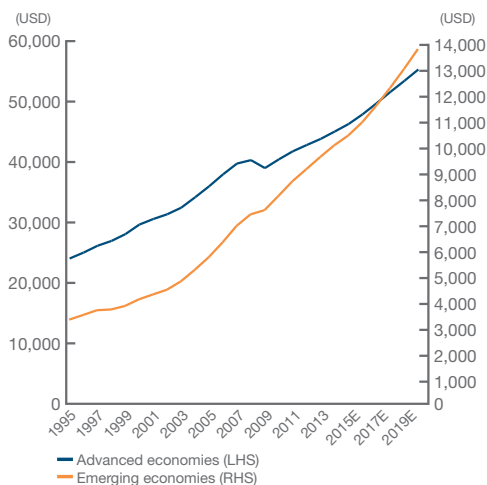
With a whole new class of consumer, driven by urbanization, income growth is a key determining factor of the overall consumption level. Historically, populations in the emerging markets have spent most, if not all, of their income on basic necessities such as food and housing. However, as incomes rise, the proportion of income spent on basic necessities gradually decreases while the proportion spent on discretionary items, such as cars, clothing and appliances, increases. In other words, rising incomes in the emerging markets are transitioning a significant proportion of the population out of poverty and into middle class status.

From 2006 to 2013, incomes have steadily risen in the emerging markets at an average annual rate of 6.4%.⁹ In 2014, emerging economies generated over \$10,000 of GDP per capita, a significant increase from \$3,200 and \$5,300 just 20 and 10 years ago, respectively.¹⁰ GDP is expected to rise to around \$13,800 by 2020, according to estimates from the International Monetary Fund (IMF).

We are already seeing the effects of this increasing middle class on disposable income levels. In Asia, real wages grew 6.0% in 2013, significantly above the global average of 2.0%.¹¹ As was experienced in developed countries, as disposable income rises consumer tastes become more sophisticated and brand awareness increases, leading to more spending on discretionary items.

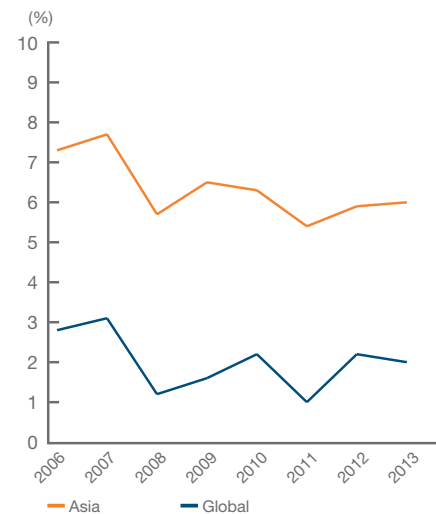
Rising income levels combined with a growing, newly minted consumer class strongly points towards the emerging markets being the natural driver behind global consumption. Companies with operations in the emerging markets have already been beneficiaries of this income growth yet we believe we are still in the early stages of this phenomenon.

GDP PER CAPITA, PPP



Source: IMF, World Economic Outlook, April 2015.

GROWTH OF AVERAGE REAL WAGES IN ASIA AND THE WORLD



Source: ILO: Global Wage Report 2014/2015.

Estimates and forecasts are only projections and not guarantees.

⁹ International Labour Organization: Global Wage Report 2014/2015.

¹⁰ According to IMF, per capita income is calculated from readily-available GDP and population estimates.

¹¹ International Labour Organization: Global Wage Report 2014/2015.

Favorable Demographics

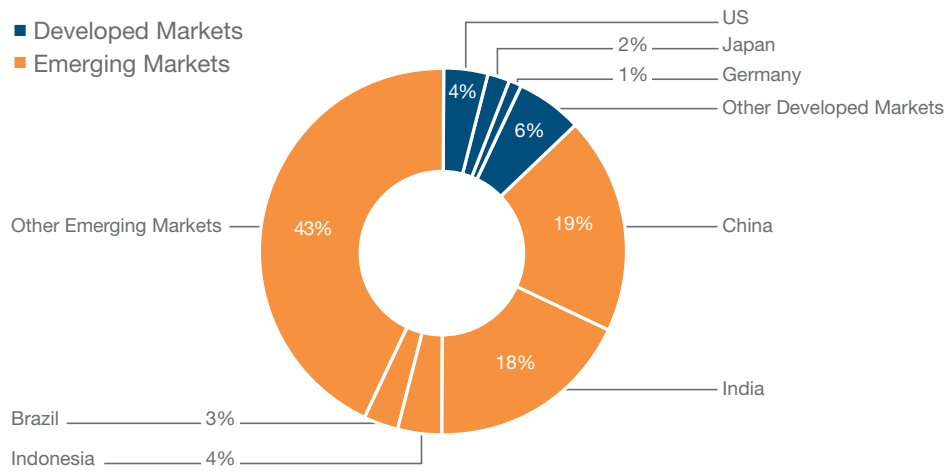
If the phrase “people are our greatest asset” is correct, then the emerging markets are indeed rich. In 2013, the population in emerging markets accounted for more than 85% of the world’s population. India and China alone accounted for a total of 2.6 billion people, or 37% of the world’s population. According to estimates from the United Nations, the world will have more than 8 billion people by 2025, up from 7.1 billion in 2013. A significant portion of this increase will occur in the emerging markets.

The key determining factor behind our thesis though is not purely the absolute population numbers in the emerging markets but more specifically the positive demographics. Despite their differences, there are two key demographic commonalities across many emerging market countries, namely that these populations tend to be younger than their developed market counterparts and also have increasing levels of education.

The populations in many developed countries, such as Japan, the U.K. and the U.S. are aging, with the situation most pronounced in Japan. In the U.S., the Baby

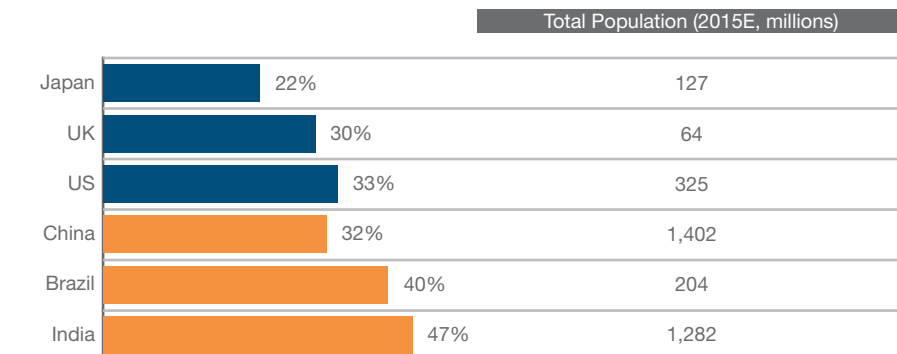
Boomers who were once drivers of population growth are now entering retirement and exiting the labor force. The chart below highlights the extent of this situation with the percentage of the population under the age of 25 at 40% and 47% in Brazil and India, respectively, compared with 33% in the United States and only 22% in Japan. Positive demographics such as these are evident across the emerging markets. As an example, in Indonesia, the percentage of the population aged 15-29 is 24% with only 5% of the population aged 65 or over, far lower than that of developed countries.¹²

WORLD POPULATION (2013)



Source: World Bank. Totals may not add up to 100% due to rounding.

POPULATION UNDER THE AGE OF 25 (2015E)



Source: United Nations, Department of Economic and Social Affairs, Population Division, 2012 Revision.

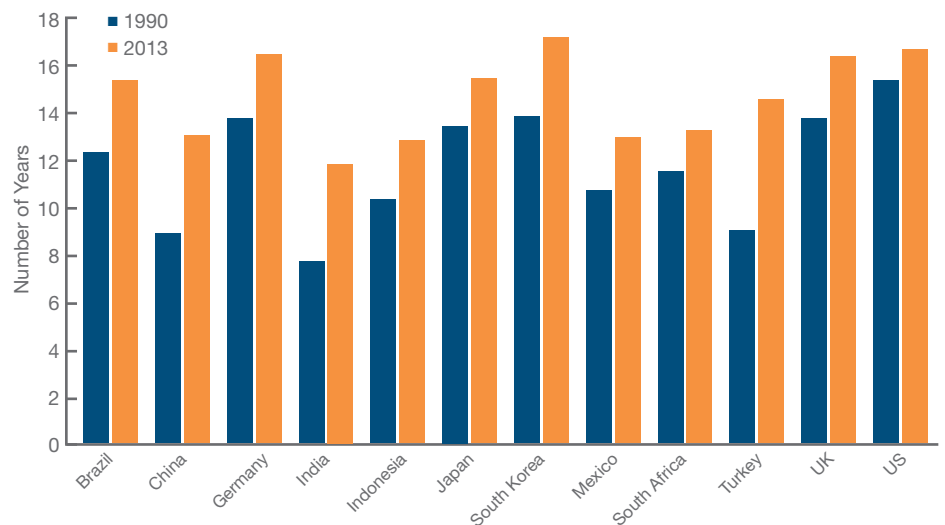
Estimates and forecasts are only projections and not guarantees.

¹² United Nations, Department of Economic and Social Affairs, Population Division, 2012 Revision.

Moreover, the workforce in the emerging markets is not only large and young, they are attaining higher levels of education. Although developed countries still have the highest average number of years of education per person, greater emphasis is being placed on education within emerging markets. As the chart below illustrates, the number of years of education in emerging economies is rising. Emerging economies are also experiencing a rise in the percentage of their populations who are pursuing higher education. For example, 67.1% of the population in South Korea between the ages of 25 and 34 had university degrees in 2013, up from just 36.9% in 2000.¹³

A younger, more educated workforce tends to be more innovative and is better at leveraging technology, both of which are vital in boosting productivity and generating growth for an economy. In addition to being a powerful force in the labor market, these younger populations will also play a significant role as consumers going forward. With more of the young population entering into the peak of their earnings cycle over the coming decades, backed by the two key factors of youth and education as described above, we are almost certain to see a corresponding rise in consumer spending.

EXPECTED YEARS OF SCHOOLING FOR SELECTED COUNTRIES



Source: UNESCO Institute for Statistics (2013).

¹³ OECD (2015), Population with tertiary education.

Consumption-led Economic Growth

In the past decade, a number of emerging economies have enjoyed rapid economic growth, supported by exports and investment. As international trade proliferated in the late 1990s and early 2000s, emerging market countries positioned themselves as labor-intensive destinations owing to their low labor costs and abundant workforces, providing the competitive advantage to become successful export-led economies. The subsequent high level of accumulated capital derived from exports was invested into infrastructure improvements, spurring greater industrialization and increased productivity for these emerging economies.

China is the typical example of this export-led growth model, a model that has successfully contributed to an average annual GDP growth rate of 10% over the last decade, but is now being impacted by the difficulties facing the global economy.¹⁴ Since the financial crisis and European debt crisis, consumer demand from developed economies has substantially weakened and within the context of a sluggish global economy there has been a downward sequential impact to exporters in the emerging markets.

This external reliance on consumer demand in the developed markets and the inherent vulnerability to any slump in developed economies is why emerging economies are seeking to shift away from an export and investment-led growth model to one focusing on domestic spending. Policy makers in the emerging markets are well aware that the conventional export-led growth model utilized by Asian economies in the past is unlikely to be sustained over the longer-term and that economic growth increasingly needs to come from domestic consumption.

The weight of private consumption contribution to the GDPs of emerging countries is still quite low in relative terms. For example, China's household consumption accounts for merely 34% of its GDP, while household consumption in the U.S., U.K., Germany and Japan accounts for a substantive 68%, 65%, 56% and 61% of GDP, respectively.¹⁵ Although policy makers in the emerging markets have already taken steps to adjust their growth models toward more domestic consumption-centric economies, we believe that this is a multi-decade process that will likely drive consumption growth in the emerging markets.

GLOBAL OUTLOOK FOR GROWTH OF GDP (%), 2010-2019

	Actual Growth 2010-2013	Actual Growth 2014	Forecast Growth 2015	Projected Growth 2015-2019
United States	2.2	2.4	2.9	2.4
Europe*	0.9	1.4	1.8	2.1
of which: Euro Area	0.6	0.8	1.4	1.9
Japan	1.8	0.2	0.6	1.4
Other Advanced**	3.5	3.1	3.0	2.9
Advanced Economies	1.8	1.9	2.3	2.3
China	8.8	7.4	6.5	5.5
India	6.6	5.7	5.9	5.5
Other Developing Asia	5.2	3.9	4.6	4.3
Latin America	3.6	1.0	1.6	2.8
of which: Brazil	3.4	0.2	0.5	3.1
of which: Mexico	3.5	2.3	3.5	2.8
Middle East and North Africa	3.4	2.9	3.4	3.4
Sub-Saharan Africa	4.6	3.5	3.8	5.0
Russia, Central Asia and Southeast Europe***	4.1	0.9	-1.5	2.1
Emerging Markets and Developing Economies	6.2	4.7	4.4	4.5
World Total	3.7	3.2	3.3	3.3

Notes: Projections are based on trend growth estimates, which – for the period 2015-2019 – are adjusted for remaining output gaps.

*Europe includes 27 members of the European Union (excluding Croatia) as well as Switzerland and Norway.

**Other Advanced economies are Australia, Canada, Iceland, Israel, Hong Kong, South Korea, New Zealand, Singapore, and Taiwan Province of China.

***Southeast Europe includes Albania, Bosnia and Herzegovina, Croatia, Macedonia, Serbia and Montenegro, and Turkey.

Source: The Conference Board Global Economic Outlook 2015 and The Conference Board Total Economy Database™, September 2014 update.

Estimates and forecasts are only projections and not guarantees.

¹⁴ IMF, 2004-2013. World Economic Outlook Database April 2015.

¹⁵ World Bank, 2013 final household consumption data.

“Great Consumer” — Defined

Over the previous pages we have documented the four factors that we believe are driving the rise of the middle class in the emerging markets and how we see this as a long-term sustainable trend that will lead to rapid income growth and a resultant exponential increase in consumer spending. This uptick in emerging market consumption in our view is set to have profound and extensive positive spillover effects across a wide array of sectors in emerging economies.

In response to this phenomenon, Mirae Asset has developed a unique investment strategy designed specifically to take advantage of the long-term consumption growth trends in and beyond the traditional consumer sectors. We call this investment strategy “Great Consumer®”. Our belief is that there will be direct and indirect winners in the rise of the emerging market consumer and we seek to look beyond the obvious winners to identify the wide-ranging beneficiaries of this economic growth phenomenon.

Companies that operate in the consumer sectors, such as auto makers, apparel companies, luxury brands and retailers, are the obvious recipients of increasing consumer spending in the emerging markets and already we are seeing this play out. The

luxury goods industry is already benefiting from the emerging market consumption theme and yet future growth potential is still high. Our analysis is leading us to anticipate growth of the global luxury segment at 2.2 times the growth of global GDP through 2025. Tourism is also another beneficiary of rising consumption. From 2014 through 2020, travel from China, India and Mexico is expected to grow 163%, 42% and 37%, respectively.¹⁶

History has shown that for consumers in the early stages of wealth accumulation, luxury apparel, jewelry and automotives are the most in-demand goods. But over time, tastes and needs broaden to incorporate a wider range of services such as travel, education and health, and it is here where we see the most attractive investment opportunities. These sectors are already evidencing strong growth, but we believe they are still in the nascent stage.

It is not enough though to merely highlight the industries where we feel there will be growth, the key component of the Great Consumer investment strategy is to fully understand the emerging market consumer — what drives their tastes and requirements and then what effect this will have on the companies seeking to enter the market.

Global companies naturally face greater challenges with regards to local knowledge, local channels and local tastes which are all significant entry barriers. We believe that correct local adaptation in products and services will be a key success factor. In sectors that are more regionally varied and nuanced, winners will often be the local companies, as they are better positioned to quickly exploit consumption trends. A further characteristic of local brands is that they generally appeal to the lower-income mass market, as emerging consumers are content to stick with local brands for essential goods and services because brand power of essential items is not as strong as that of discretionary items.¹⁷

When we also factor in additional barriers to entry such as governmental protection for local companies and the imposition of tariffs on global companies, it is clear that picking winners among peers is a complex task and requires in-depth understanding of the local markets. At Mirae Asset, our on-the-ground research and local know-how gives us a unique perspective and expert insight into the complex nature of emerging markets investing.

There can be no guarantee that any strategy (risk management or otherwise) will be successful. All investing involves risk, including the potential loss of principal.

¹⁶ Source: International Trade Administration, July 2015.

¹⁷ Source: Credit Suisse, Emerging Market Consumer Survey, 2015.

For more information on the Great Consumer®
www.miraeasset.us/gc



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