

# The Long View

Investment Insights

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The Changing  
Face of the Global  
Consumer

# The Changing Face of the Global Consumer

**"The demographic changes and the growth we're seeing in China, India and other parts of the developing world are having a profound effect on the global economy, and they also have significant implications for companies in the U.S. and other parts of the developed world."**

**Jody Jonsson**, Portfolio Manager

Consumer spending, long a driver of the global economy, is undergoing sweeping change. Whether it's housing for millennials or health care for baby boomers, a significant shift in the way people spend money is underway in both advanced economies and the developing world.

One thing about spending money hasn't changed. Americans do a lot of it. Last year Americans spent more than US\$11 trillion, accounting for two-thirds of the nation's gross domestic product. But the way Americans spend money is changing. Since 2000, there has been a rotation in spending away from goods and towards services, especially travel and leisure.

That dynamic may also be at work in China, as the country continues on the path to having the world's largest consumer economy. Consumers there are starting to spend less money on necessities and more money on activities such as family trips and going to the movies.

"What we are seeing is that the Chinese are primarily spending their money online, on lifestyle and on experiences," Capital Group's China affairs specialist, Andrew Dougherty, says. "From an investment standpoint, these are secular opportunities worth paying attention to. China is the largest e-commerce market in the world and is still growing by double digits."

Capital Group Canadian Focused Equity Fund<sup>SM</sup> (Canada) portfolio manager Rob Lovelace says two demographic groups will have a major impact on the future of the global economy. "The first one is baby

boomers. They're obviously moving into retirement. Health care is one of the big aspects of that," Rob says. "At the other end are millennials, one of the largest generations and one that's grown up with the internet and technology."

Millennials were born from 1980 to 2000. There are about 80 million in the U.S., but most of the world's 2 billion millennials are living in emerging markets. In Brazil, India and China they outnumber baby boomers.

Globally, millennials are estimated to have a combined spending power of nearly US\$2.5 trillion. They are about to reach their prime working and spending years, and their impact on the world's economy could be huge.

"During the next 10 years, developing countries are expected to add about a billion people to the middle class and above," says portfolio manager Noriko Chen.

"These emerging economies will account for nearly half of total global consumption. I believe that is going to have a transformational impact on the world's economy."

At the other end of the spectrum, many baby boomers globally may be done working, but they're not done spending. While that means increased health care

spending, boomers will also be spending on travel, leisure and financial services.

"The demographic changes and the growth we're seeing in China, India and other parts of the developing world are having a profound effect on the global economy, and they also have significant implications for companies in the U.S. and other parts of the developed world," says portfolio manager Jody Jonsson.

## Key Takeaways

We live in a transformational time

- A significant shift in consumer spending may be underway across the world.
- From baby boomers to millennials, a new breed of consumers is set to transform spending habits.
- Companies that can take advantage of this transition have the potential to reap new profits, and reward investors.

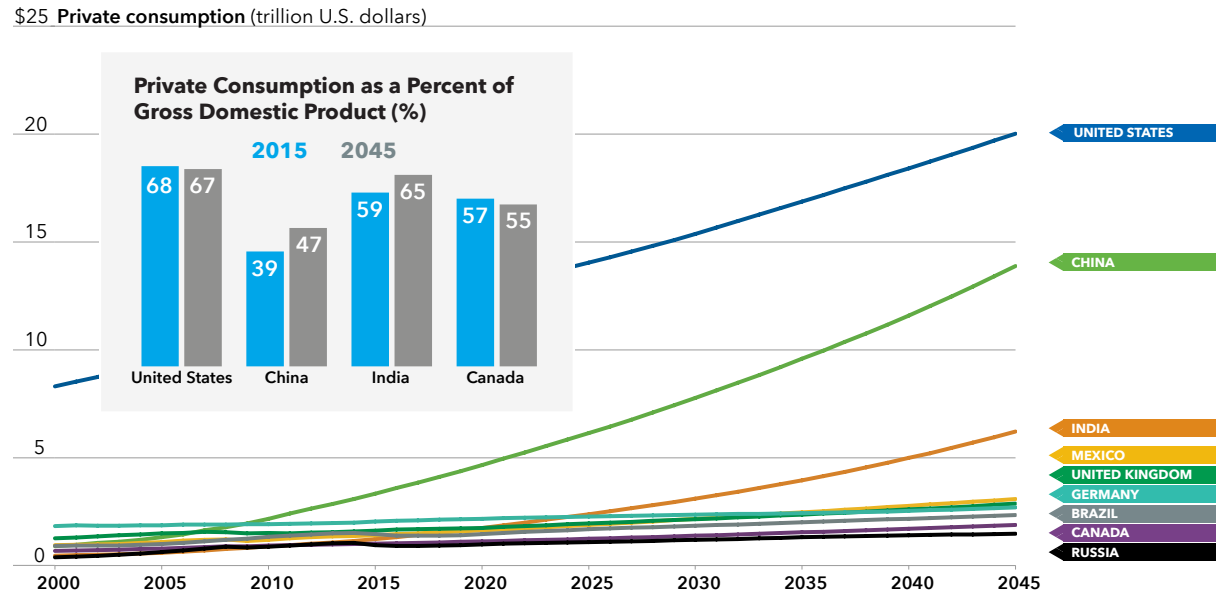


# Big Spenders: Consumers Play a US\$43 Trillion Role in Global Economy

## India and China Are Joining the U.S. as Major Drivers of Economic Growth

"The increasing affluence and the emergence of consumer classes in developing countries is a durable trend that should continue for many decades to come. It's a trend that has the potential to be one of the primary engines of economic growth."

**Rob Lovelace**, Portfolio Manager,  
Capital Group Canadian Focused Equity  
Fund<sup>SM</sup> (Canada)



Source: Thomson Reuters Datastream. Please see back cover for additional information.

- In less than a decade, something will happen for the first time in history. By 2025, 4.2 billion people will be part of the consuming class. That means the number of people with discretionary income will exceed the number still struggling to meet basic needs – a phenomenon that may well be the biggest opportunity in the history of capitalism. This improvement in the standard of living represents a remarkable transformation for the global economy and companies around the world.
- Consumer spending has long been a significant element of the world's

economic expansion. The gross domestic product (GDP) in the U.S., for example, is nearly US\$18 trillion. About two-thirds of that comes from consumer spending on goods and services, including cars and furniture, food and beverages, and health care and housing. Global GDP is about US\$75 trillion, and consumers account for about 57% of that amount, or about US\$43 trillion. Consumer spending represents a majority of spending in all advanced nations, and the way people spend money is undergoing a major shift in many countries.

- An April 2016 report from the McKinsey Global Institute found that although demand for goods is still growing at a respectable rate in many economies, consumption is shifting toward services. In short, as per capita incomes rise, less money is spent on necessities such as groceries, and more money is spent on services like restaurants, hotels, recreation and cultural activities. This evolution is well underway in developing countries around the world as millions move into the middle and upper-middle classes.

# In China, Spending Is a Family Affair

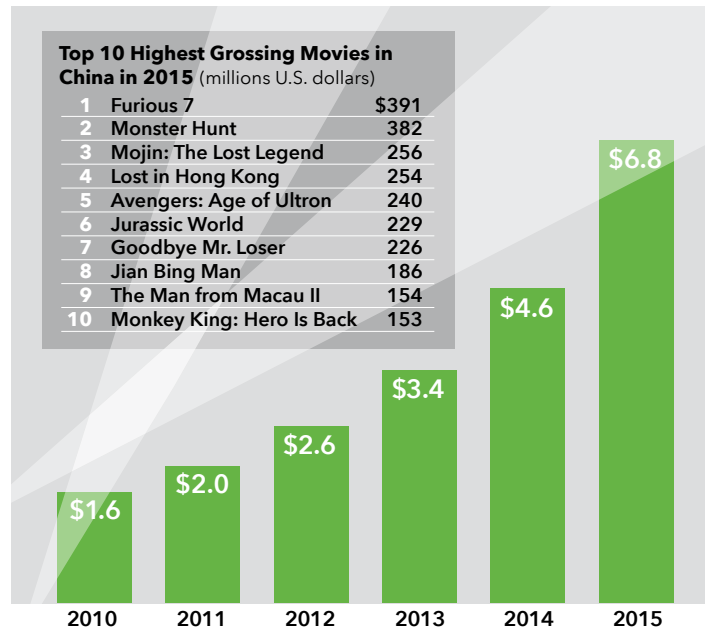
Chinese Consumers Are Expected to Spend US\$3.6 Trillion This Year

"China's service sector has surpassed the manufacturing and agricultural sectors as the leading sector in the economy and now represents more than half of China's GDP. So, that's a good indicator that the economy is rebalancing away from manufacturing and investment and toward services and consumption."

Andrew Dougherty, Capital Group China Affairs Specialist

## Box Office Revenue in China

(billion U.S. dollars)



## International Tourism Expenditure of Chinese Tourists

(billion U.S. dollars)



Sources: (China) State Administration of Radio, Film and Television, Statista Inc. and Xinhua News Agency (box office revenue); Box Office Mojo at [www.boxofficemojo.com](http://www.boxofficemojo.com) (top 10 movies); and Statista Inc. and United Nations World Tourism Organization (international tourism expenditure). Please see back cover for additional information.

- Never underestimate the power of the Chinese consumer. Complex and massive, volatile and unpredictable, the 1 billion consumers in China are not exactly clinging to their yuan. Despite a relatively sluggish economy, the Chinese are projected to spend US\$3.6 trillion this year, or double what they spent in 2006. They are also expected to increase their spending by 10% a year through the end of the decade. They are not just filling the basket with consumer staples – for some, shopping is about the experience.
- Going to the movies and taking family trips abroad have become part of Chinese life. More than 70 million Chinese tourists spent US\$292 billion on outbound travel in 2015, or nearly three times the level in 2012. Many of those trips are booked through Ctrip, an online travel firm partly owned by Priceline and Baidu, the Chinese internet search giant. The surge in Chinese outbound travel is a multidecade theme driving structural growth in the airline, gaming and internet industries.
- China's box office revenue is projected to reach US\$8.4 billion in 2016, and grow to US\$15 billion in 2020. What Hollywood movie has made the most money in China? *Furious 7* took in US\$391 million at the box office last year. For many, spending is about going places with the family, a dynamic that's benefiting Disney, which opened a US\$5.5 billion theme park in Shanghai in June – the company's biggest investment outside Florida. By August, the theme park had already welcomed its millionth visitor.

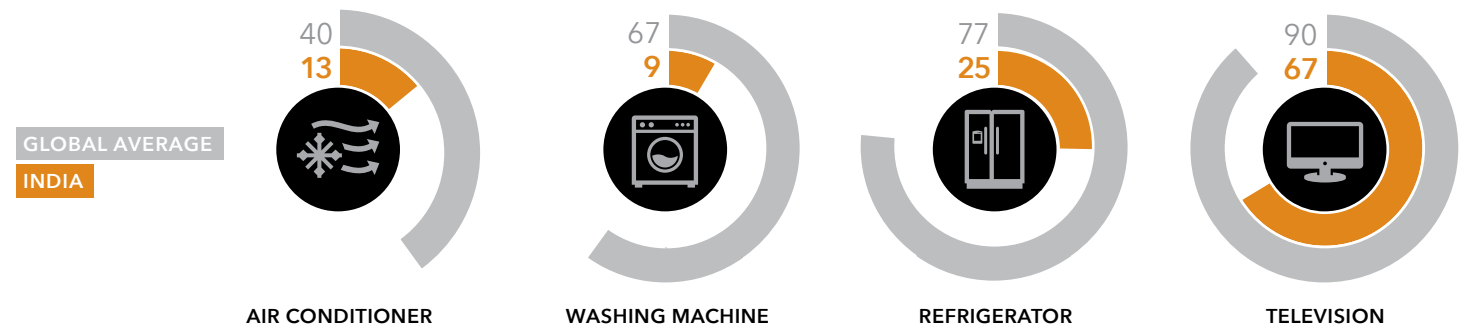
# India Emerges as a Massive Market

The Country May Still Be on the Ground Level as a Consumer Society

“India has a lot going for it in terms of favourable demographics, the possibility of a downward trend in inflation and a substantial reform agenda. If reforms are forthcoming, its economy could really take off, similar to the way China’s did.”

Nick Grace, Portfolio Manager

## Households That Own Durable Goods (%), as of 2015



| Key Players in the Consumer Appliance and Electronics Market |  |  |  |  |
|--|--|--|--|--|
| BOSCH  |  |  |  |  |
| LG   |  |  |  |  |
| SAMSUNG  |  |  |  |  |
| SONY   |  |  |  |  |
| WHIRLPOOL  |  |  |  |  |

Source: Euromonitor International. Data are based on possession rate, which is a measure of how many of the population units used (e.g., households) own at least one unit of a certain product, as defined by Euromonitor.

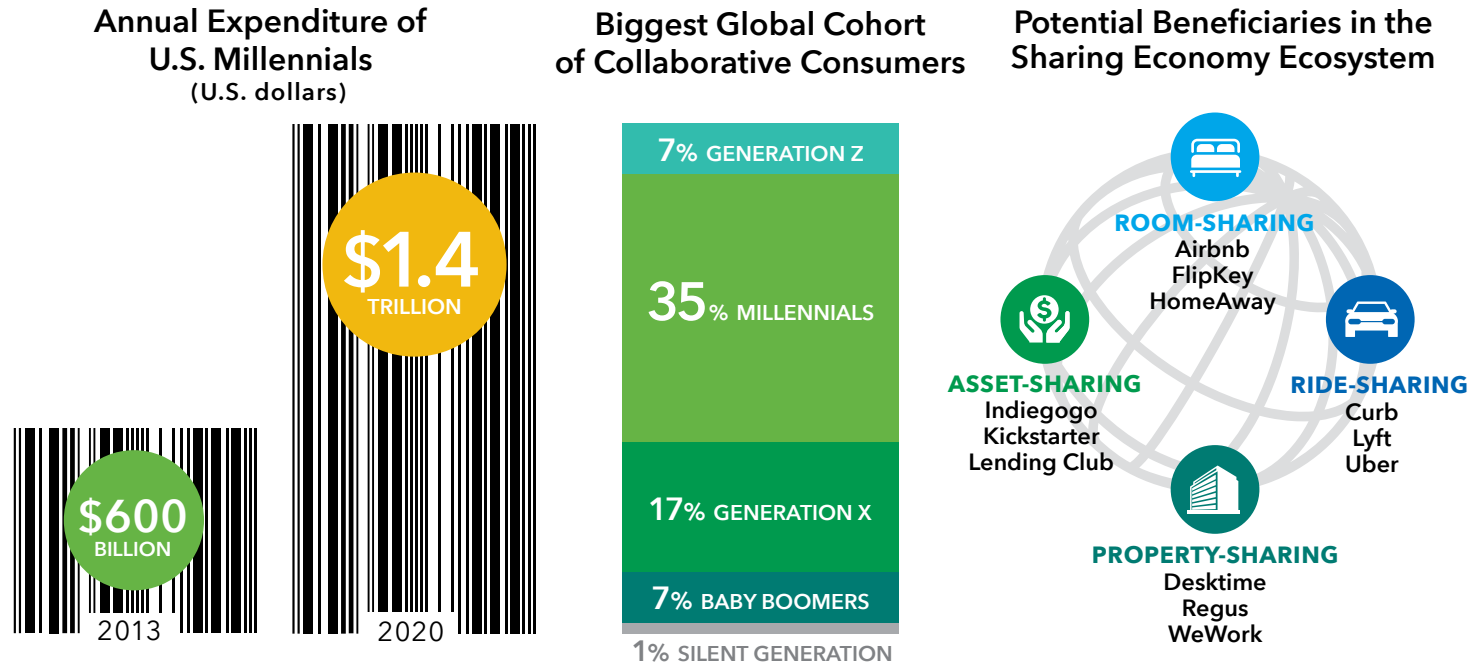
- India embarked on a journey about 25 years ago, opening its doors to globalization and world markets. Since then, the country has become one of the most important components of the global economy. India’s growth has overtaken that of fellow Asian giant China. One of the key components of the country’s economic growth is brisk consumer spending, which propelled growth in India’s economy to 7.6% as of the end of the country’s 2015 fiscal year – the fastest pace in at least four years.
- When it comes to being an economic powerhouse, India may just be getting started. The chart shows that the country still lags much of the world in having items such as refrigerators and air conditioners. But modernization is progressing at a relatively rapid rate, both in terms of personal consumption and modernizing infrastructure. Under Prime Minister Narendra Modi, highways, airports and railways are being improved, which could provide opportunities for companies and boost the economy.
- India also stands to benefit from a demographic tailwind during the coming decades. India has about 440 million millennials and 390 million members of Gen Z (born after 2000) that make up its 1.3 billion population. Over the next decade, about 150 million new people will enter India’s workforce. That’s about the present size of the entire U.S. workforce. A swelling workforce makes it likely India will continue to be a massive market for consumer companies and a major economic force.

# Millennials: Aren't They About Ready to Start Buying ... Everything?

Collaborative and Disruptive, Millennials Are Beginning to Flex Their Financial Muscles

"Millennials still consider home ownership important. I think they will become more active buyers of traditional single family houses after they resolve financial constraints."

Alex Sheynkman, Investment Analyst



Sources: Statista Inc. (annual expenditure of U.S. millennials) and *The Sharing Economy*, Credit Suisse, September 18, 2015 (percent of collaborative consumers). The figure for annual expenditure of U.S. millennials for 2013 is an estimate, and for 2020, it is a forecast. The percent of collaborative consumers by generational cohort is based on a 2014 survey conducted by The Nielsen Company and Credit Suisse research.

- Talk about pent-up demand. Millennials have been battered by the Great Recession, swamped with student debt and stuck in their parents' basements for years. They've put off getting married, having kids and buying a car, much less a house. But those days may be coming to an end. In fact, the members of the biggest generation in U.S. history may be about ready to flex their financial muscles. There are about 80 million millennials in the U.S. alone, and they are already spending at least US\$600 billion a year.
- Millennials are also taking a collaborative and disruptive approach to consumption. Technology has made sharing assets relatively inexpensive and possible on a large scale. In the sharing economy, people rent rooms, cars or luxury purses directly from each other via the internet. Some companies facilitating this collaborative consumption now have multibillion market caps, including Airbnb, Uber and HomeAway. By 2025, according to consulting firm PricewaterhouseCoopers, the sharing economy may account for US\$335 billion in global spending.
- While millennials are already a potent force, they will truly come into their own by 2020, when their spending in the United States is expected to reach US\$1.4 trillion annually. Some of that money may go to purchases that have been put off in the wake of the Great Recession. As millennials enter their peak home-buying years, for example, their reluctance to enter the housing market could change. The cohort's size, plus its desire to settle down in the future, could lead to a surge in household formations and home sales.

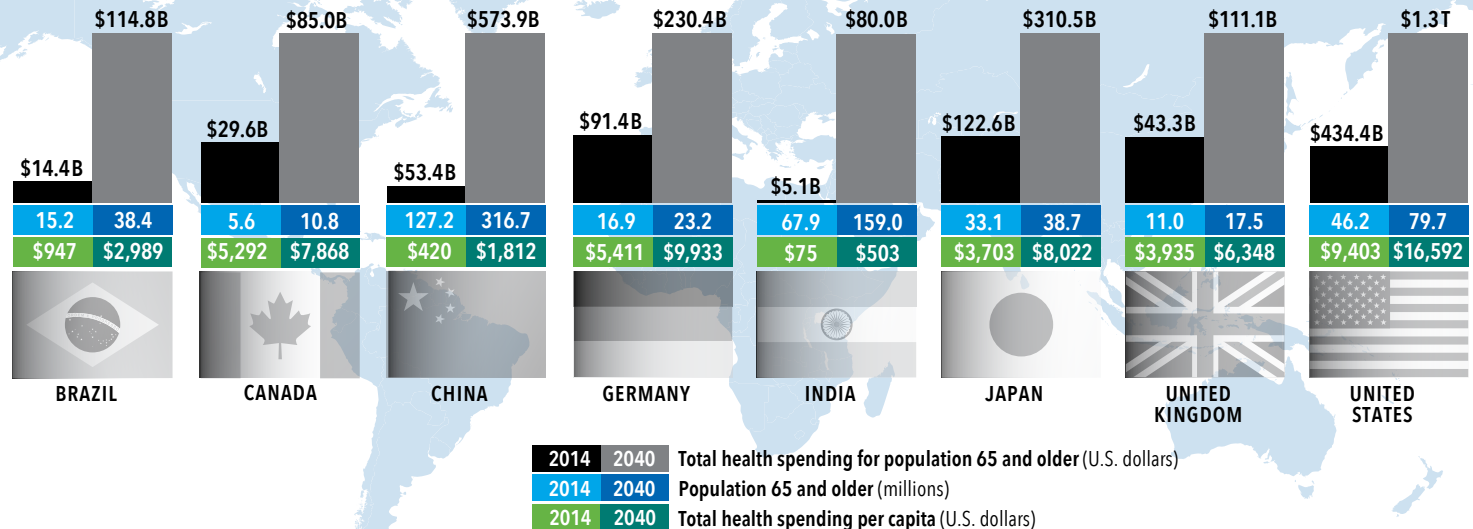
## 1.3 Billion Shades of Gray

Silver Will Be the New Black as Populations Age

"In coming decades, many forces will shape our economy and our society, but in all likelihood no single factor will have as pervasive an effect as the aging of our population."

Ben Bernanke, former Chairman,  
U.S. Federal Reserve

### As Populations Age, Health Care Spending Is Expected to Soar



Sources: OECD (population 65 and older); The World Bank (health spending for 2014); and "National Spending on Health by Source for 184 Countries Between 2013 and 2040," *The Lancet*, Dr. Joseph L. Dieleman et al., June 18, 2016 (health spending for 2040). Please see back cover for additional information.

- A striking demographic change is taking place worldwide, as people live longer than ever before and fertility rates fall in many regions. Globally, the number of those aged 65 and over is growing at around twice the rate of the overall population. By 2040, the global population of people aged 65 and older will double to almost 1.3 billion. The implications of a demographic shift of such magnitude are far reaching. Globally, the spending power of consumers age 60 and older will hit US\$15 trillion by the

end of this decade, up from US\$8 trillion in 2010, according to Euromonitor, a global research firm.

- Health care and pharmaceuticals, leisure and tourism and financial services are seen as some of the key sectors likely to benefit. They will not be alone: consumer goods, food and beverages, retail and technology companies are also expected to find new opportunities. For some specialized companies, longevity already offers significant growth opportunities.

- Companies that already sell primarily to older consumers, such as health care and medical device manufacturers, see a potential bonanza coming. One example is Smith & Nephew, which sells replacement hip and knee joints, largely to an older population, and lists aging populations as one of its key drivers of growth. This age cohort is now the fastest growing primary segment of the world's population and its growth rate is outstripped only by that of an older subgroup – those aged 80 and above.

## Investment Professional Biographies



**Joanna (Jody) F. Jonsson** is an equity portfolio manager at Capital Group. She has 27 years of investment experience and has been with Capital Group for 25 years. Earlier in her career, as an equity investment analyst at Capital, Jody covered insurance, U.S. household & personal care, restaurants & lodging and cruise lines companies. Before joining Capital, she was an equity research analyst at Fidelity Management & Research Company in Boston and an officer in the public finance division of Irving Trust Company in New York. Jody holds an MBA from Stanford Graduate School of Business, where she was an Arjay Miller Scholar, and a bachelor's degree in economics from Princeton University graduating cum laude. She holds the Chartered Financial Analyst® designation and is a member of the CFA Institute. Jody is based in Los Angeles.



**Andrew H. Dougherty** is a China affairs specialist at Capital Group. He has 11 years of investment industry experience, all with Capital Group. Andrew began his career at Capital as a participant in The Associates Program, a two-year series of work assignments in various areas of the organization. He holds a master of philosophy in modern Chinese studies from the University of Cambridge and a bachelor's degree in economics and international affairs from George Washington University. Andrew is based in Beijing.



**Robert W. Lovelace** is an equity portfolio manager at Capital Group and is one of the portfolio managers of Capital Group Canadian Focused Equity Fund (Canada). He also serves on the Capital Group Companies Management Committee. Rob has 30 years of investment experience, all with Capital Group. Earlier in his career, Rob was an equity investment analyst at Capital covering global mining & metals companies and companies domiciled in Mexico and the Philippines. He holds a bachelor's degree in mineral economics (geology) from Princeton University graduating summa cum laude and Phi Beta Kappa. He also holds the Chartered Financial Analyst® designation. Rob is based in Los Angeles.



**Noriko Honda Chen** is an equity portfolio manager at Capital Group. She also serves on the Capital Group Companies Management Committee. She has 25 years of investment experience and has been with Capital Group for 17 years. Earlier in her career, as an equity investment analyst at Capital, Noriko covered Asian infrastructure, building materials and construction companies, as well as oil, gas & refining companies. She was also a research director for one of the global groups. Before joining Capital, she worked in the research department of Worldsec International Limited in Hong Kong (a subsidiary of Mitsubishi Bank) and was a manager in corporate finance. Noriko holds a bachelor's degree in economics from Williams College and a degree in the Japanese Language Bekka Program at Keio University, Tokyo. Noriko is based in San Francisco.



**Nicholas J. Grace** is an equity portfolio manager at Capital Group. He has 26 years of investment experience and has been with Capital Group for 22 years. Earlier in his career, as an equity investment analyst at Capital, he covered global mining companies. Prior to joining Capital, he was manager of metals research for J.P. Morgan Investment Management in Australia. Nick holds an MBA from the University of Wisconsin-Madison, and a bachelor's degree in finance and economics from the University of Waikato, New Zealand, graduating with honors. He also holds the Chartered Financial Analyst® designation. Nick is based in London.



**Alex Sheynkman** is an equity investment analyst at Capital Group with research responsibility for U.S. PC/enterprise hardware manufacturers, photographic products, office electronics imaging equipment, REITS and homebuilding companies. He has 18 years of investment experience and has been with Capital Group for 15 years. Prior to joining Capital, Alex was a research analyst with Merrill Lynch and a research associate with Sanford Bernstein. Before that, he was a consultant with Bankers Trust. He holds an MBA from New York University's Stern School of Business and a bachelor's degree from Moscow Telecommunication Academia. Alex is based in Washington, D.C.



**The following information pertains to the charts on the pages specified below.**

**Page 1:** Private consumption represents the volume of goods and services consumed by households and nonprofit institutions serving households. Data, based on 2010 constant prices not seasonally adjusted, from 2016 and forward are forecasts for all countries shown; for China, forecasts are from 2015. Values for consumption as a percent of gross domestic product (GDP) are expressed as a share of nominal GDP.

**Page 2:** The figures for box office revenue were converted from Chinese yuan into U.S. dollars using one exchange rate as of December 31, 2015; these figures, therefore, are estimates. The top 10 highest grossing movies for 2015 are based on box office results updated in

August 2016. The figure for international tourism expenditure for 2015 is a forecast.

**Page 5:** Data for population 65 and older for 2014 and 2040 are from the Organisation for Economic Co-operation and Development (OECD); United Nations *World Population Prospects, The 2010 Revision* (Brazil, China and India); Destatis (Germany); National Institute of Population and Social Security Research (Japan); Office for National Statistics (United Kingdom); and U.S. Census Bureau (United States). Historical population data and projections (1950-2050) were accessed via OECD's Demography and Population database at <https://stats.oecd.org> on August 29, 2016. Data for health spending for 2014 are from The World Bank, World Development Indicators, World Health Organization Global

Health Expenditure database. Data, which represent the sum of public and private health expenditures as a ratio of total population, are in current U.S. dollars. Health spending per capita projections for 2040 are from Joseph L. Dieleman, PhD, Tara Templin, BA, Nafis Sadat, MA, Patrick Reidy, BA, Abigail Chapin, BA, Kyle Foreman, PhD, Annie Haakenstad, MA, Tim Evans, MD, Christopher J. L. Murray, MD, and Christoph Kurowski, MD, as published in "National Spending on Health by Source for 184 Countries Between 2013 and 2040," *The Lancet*, Volume 387, Issue 10037, Pages 2521-2532, June 18, 2016, [http://dx.doi.org/10.1016/S0140-6736\(16\)30167-2](http://dx.doi.org/10.1016/S0140-6736(16)30167-2). Data were extracted from the World Health Organization's Health Spending Observatory and the Institute for Health Metrics and

Evaluation's Financing Global Health 2015 report. Data were converted to a common purchasing power-adjusted and inflation-adjusted currency. A series of ensemble models and observed empirical norms were used to estimate future government out-of-pocket private prepaid health spending and development assistance for health. Each country's estimates were aggregated to generate total health spending from 2013 to 2040. These estimates were compared with each other and internationally recognized benchmarks. Data for total health spending for population 65 and older were not plotted on the same scale for the countries shown.

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