



GLOBAL PERSPECTIVES

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INVESTING LIKE LEE KUAN YEW

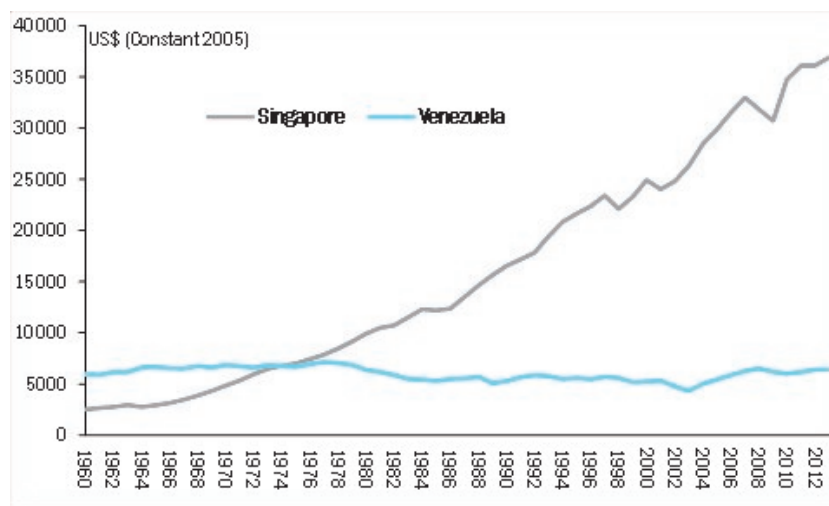
The world recently lost one of the great political leaders of the post-World War II era, the founding father of modern Singapore, Lee Kuan Yew. *From Third World To First*, Lee's autobiographical account of Singapore's rise, is a must read for anyone interested in strategies for economic development. It is also crucial in analyzing the outlook for many other nations (most notably China) that have borrowed liberally from the Lee Kuan Yew playbook. I find the keys to Singapore's success under Lee's leadership particularly relevant to reflect on against today's economic backdrop.

The global economy is demonstrating sluggish growth and there are widespread fears of deflation. In many industries, capacity was built in recent years in anticipation of demand growth from emerging markets that has failed to materialize. The response to these growth and deflation challenges has been unprecedented levels of central bank stimulative action across the developed world. While the resulting extremely low global interest rates have helped boost the values of some assets, they have also served to enable two potentially counterproductive forces. First, the low cost of financing has allowed unproductive capacity to stay in place, exacerbating the challenges of pricing power in many industries. Second, the crutch of monetary stimulus has reduced the level of urgency for forceful government and corporate reforms. Why do potentially unpopular and difficult things when cheap money appears to be a "free lunch"?

So what would Lee Kuan Yew advocate to stand out in such an environment? I believe we can look to two key pillars of Singapore's historical ascent. First, there has been a continuing focus on disciplined governance reforms and improvement. Whatever concerns some may have about Singapore's system, the competence and integrity of governance there has always set an extremely high standard. Second, Lee would likely point to the need for a relentless drive to climb the value chain in production in order to stay ahead of commoditization. When Singapore became independent in 1965, it had little in the way of clear, differentiated resources; yet it has systemically built share in the most highly value-added lines of business serving the region and the world. When compared to the outcomes for resource-rich, governance poor Venezuela over the same period, the divergence in results is stunning (Exhibit 1). Even relative to Hong Kong, a success story in its own right, Singapore has climbed from only 50% of Hong Kong's per capita income in 1960 to a 10% premium today. We feel that the disciplines that drove Singapore's remarkable success are as relevant today as ever. Therefore, we are very focused on finding investable themes with exposure to these same factors.

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Exhibit 1: Singapore GDP per capita vs. Venezuela, 1960-2013



Sources: World Bank, Asianomics Group Limited

Exposure to improving governance and value-added ascension can come in many forms and occasionally one can find the two themes intersecting. One of the hotbeds for these themes today is India. India has long held immense economic development potential, but has been notorious for inefficient bureaucracy. However, under the leadership of recently elected Prime Minister Narendra Modi there is real evidence of change. The Modi administration has pursued systematic and methodical governance reform to eliminate corruption and reduce wasteful capital allocation and markets have responded optimistically. We are seeing similar progress in the corporate sector with modest governance reform and noteworthy advancement in development of intellectual property value-added. Key Indian businesses are clearly making real forward progress on their global competitiveness. Technology services companies that once did purely low-cost outsourcing are now doing cutting edge software development. The generic pharmaceutical industry (that once thrived on low-cost knock-offs of successful Western drugs) is now doing much more advanced research and development work. Where we find governance reforms intersecting with clear deltas in levels of value-added output, we think it can be a powerful combination.

While this is not the only lens through which to view today's investing landscape, it is important and broadly relevant. Japan's reform efforts at the national and corporate levels are encouraging, particularly when one can gain exposure to those themes in globally competitive businesses not solely tied to Japanese domestic demand, e.g. automation. ASEAN nations such as Indonesia and the Philippines are showing encouraging signs of advancement on governance and global competitiveness. Ten years ago, the Philippines was sending labor abroad as primarily low-cost domestic help and construction workers. Increasingly, that is shifting towards roles such as well-trained nurses and architects (with resulting growth in remittances). That kind of progress is crucial in an increasingly global and automated world with broad overcapacity of commoditized goods and labor. At the other end of the spectrum, Russia and Brazil's lack of progress on these issues is increasingly damaging their economic prospects. Perhaps more subtly, the question of levels of progress on these two fronts is crucial to one's longer-term view of European prospects. Can substantive reforms in Euro area governance advance? In what European industries and companies do we see progress on global competitiveness and value-added growth? Particularly outside of Germany and the UK, are there sufficient levels of technological advancement and value-added output in the eurozone, or too much reliance on eroding legacy franchises at risk of being bypassed in the global marketplace? In the U.S. where value-added output leadership in key industries such as technology and healthcare has led the recent recovery, can that growth continue, or is the global competition gaining ground? Are there potential business-unfriendly government policy risks on the horizon? When pondering these key investment decisions, I would suggest keeping in mind the framework of: What would Lee Kuan Yew think.

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