Critical Insights

Part 2: Socio-Economics

DGC Asset Management Limited is a UK-based project developer and consultancy. This series of reports is intended to provide investors with an insight into developing trends in the underlying fundamentals that shape the global economy and investing landscape. Our goal is to drive better decision making for those considering long-term investment strategies.

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Foreword

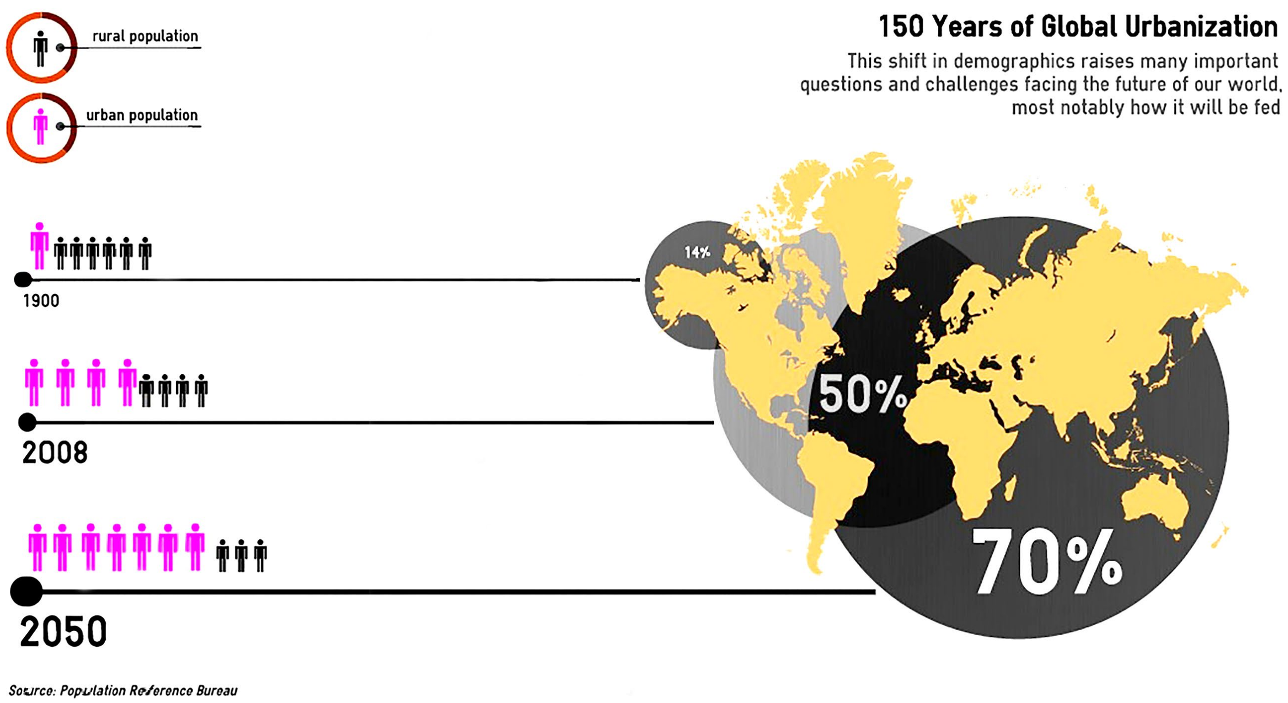
We leave Part 1 of the Critical Insights series with a handle on how developing trends in basic demographic fundamentals; such as exponential population growth, rapid expansion of the oldest demographic groups, and the urbanisation of over 70% of the world populace by 2050, are shaping the world we live in, as well as the landscape for investors.

A larger, older, and fully urbanised global population exhibits a markedly different demand dynamic, requiring different products and services delivered in a different way than generations past and present. These factors are how shaping the investment decisions of institutions and governments around the world, noted by a significant shift away from traditional financial markets in favour of useful, productive assets that play a significant role in the production of high-demand commodities such as food, energy, infrastructure and housing.

Today we enter Part 2, and we investigate the social and economic mega-trends that result from this on-going demographic evolution. Rapid economic expansion (GDP growth), especially in fast-developing emerging markets, is expanding household incomes at an astonishing pace. This in turn is driving the most important multi-generational social changes since the industrial revolution.

As the population expands and becomes wealthier, demand for resources is increasing rapidly. In emerging markets, energy consumption rides high on the back of growing manufacturing industries, infrastructure development, and the widespread use of modern transport. Meanwhile, as widespread employment becomes the norm, individuals and households seek to improve their diets, aiming primarily to achieve the high-calorie, high-protein standard set in industrialised western nations. As more people each consume more resources on a daily basis, the global supply chain must evolve and adapt. So too must investors, as this new-normal demand dynamic creates an inherent value in key asset classes fundamental to the production of essential commodities, yet limited in supply.

Read on to gain insight into the what, where, why, who and how of global these mega-trends from the point of view of today's investor.



GDP Growth

Basing investment decisions on the growth dynamics of today's economy

Economic growth, in broad terms, has been the bedrock of investment returns since the initial public offering of the Dutch East India Company in 1602. Since this first ever public issue of company stock, investors have relied almost entirely on the performance of financial markets to capture economic growth in the form of company profits distributed as dividends, and growth in the size and value of underlying companies participating in the manufacture and supply of products and services.

Until very recently, the vast majority of this growth has occurred in what are now well-developed, industrialised markets such as the United Kingdom, Europe and North America. Investors therefore could largely rely on a fairly predictable status quo of on-going growth and income, captured through exposure to companies operating in these markets. Stock and bonds ruled the day, and have historically delivered a sufficient return on investment in the long term so as to provide for a comfortable retirement for most investors.

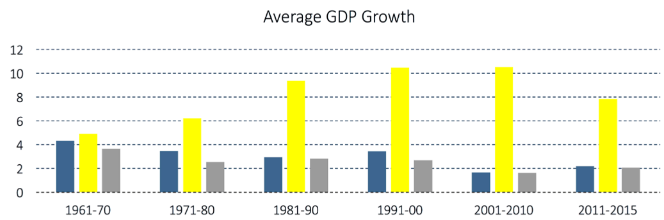
Today, the landscape is markedly different. Growth has shifted to emerging markets as the West struggles to stave off deflation and recession. Weak growth combines with poor demographics to deny markets the growth and income that has been relied upon for generations. Traditional investment strategies that have served previous generations so well therefore, can no longer be relied upon to protect and grow wealth, and today's investor must look elsewhere. But with global financial markets in a seemingly perpetual state of borderline collapse, where might one find safety, as well as value?

1.93%
Avg. Annual GDP Growth
USA 2001 – 2015

1.84%
Avg. Annual GDP Growth
UK 2001 – 2015

9.18%
Avg. Annual GDP Growth
China 2001 – 2015

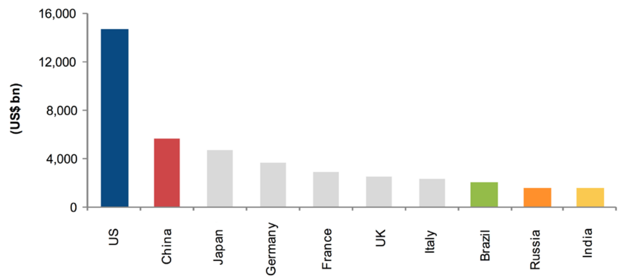
Emerging markets now account for the lion's share of economic growth, fuelled by modern technology and mechanisation, rather than the comparatively slow combination of coal and manual labour that fuelled the growth of today's modern economies. The pace of this growth is driving an economic, social and cultural evolution that is taking place at an astonishing pace. It is shaping the future of the global supply chain for food, feed and fuel, and has created an entirely new dynamic for investors aiming to gain exposure to today's growth.



Sources: Between 1980 - 2015: The World Bank, Between 1961 - 1980: The United Nations

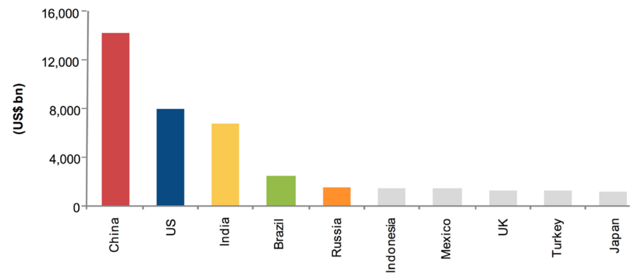
Exhibit 1: Largest economies in 2010 and 2015

Largest economies in 2010 - 2015



Source: Goldman Sachs Research, Bloomberg

Largest economies in 2050

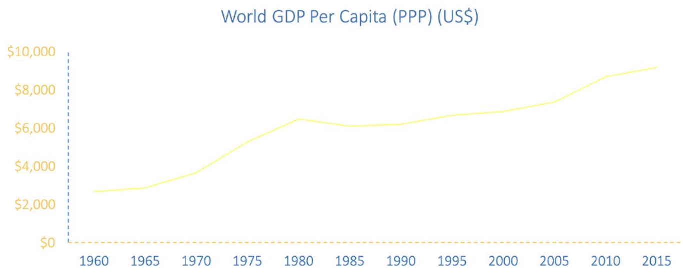


Source: Goldman Sachs Research, Bloomberg

Rising Household Income

As the global population becomes wealthier, resources and the supply chain must adapt.

Perhaps the most significant impact of fast-paced economic growth and urbanisation, is rising household income. As populations and economies evolve from rural and agricultural, to urbanised and high-tech, household incomes expand, leaving huge and growing populations such as those of the BRIC economies with more disposable income and the means to seek out a higher standard of living.



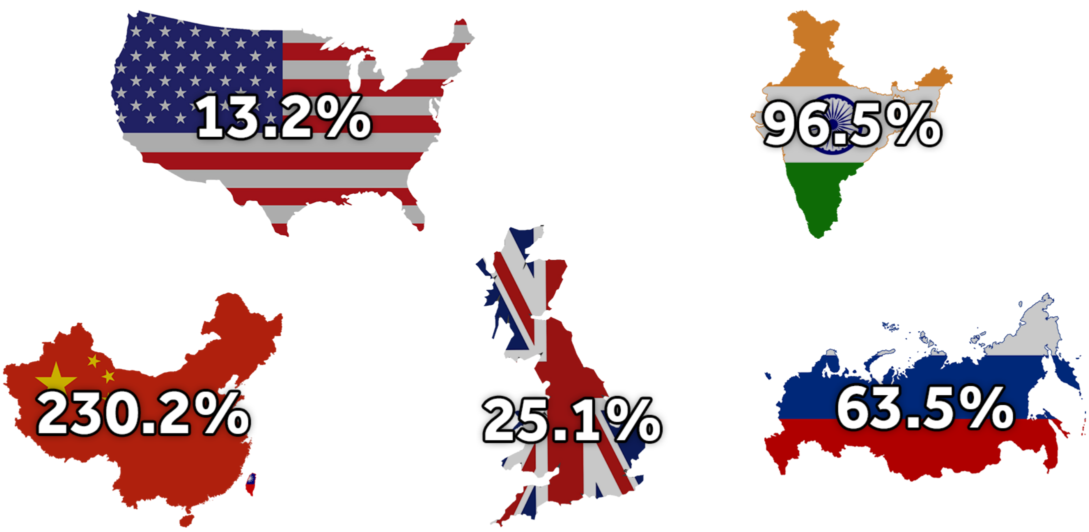
Source: World Developement Bank

As with economic growth, growth in household income is occurring much faster in emerging markets. Between 1990 and 2010, disposable household income in the United States rose by 13.2%. meanwhile in China, the amount of cash available to households after the cost of living grew by 230.2%. Yet there is still significant room for further growth before emerging market populations reach the levels of disposable income enjoyed in the West. American families have circa. $ 61,028 to spend, whereas their Chinese counterparts have just $4, 809. So Chinese disposable income could rise by 1,169% before parity is reached.

As these populations continue to shift towards a higher level of consumerism, spending their rising levels of excess cash on a more westernised standard of living and level of consumption, the pressure on existing resources such as food, timber, other raw materials and energy is already immense. As 2 billion people in the developed world have exhausted 50% of the global resource asset base in less than 200 years, what happens when a further 5 billion people demand the same level of consumption? It is safe to say owners of these assets will be well-positioned to profit.

With this in mind we must look to the detail of the social and cultural changes that result from a wealthier global population, and this, when understood, helps to guide us towards sectors and assets set to become ever more valuable as demand for specific goods and services continues to grow.

Growth in household desposable income 1990 - 2015



Source: World Developement Bank

Dietary Shift

The 5 Billion Person High Calorie Diet Plan

As we have alluded to already, mass urbanisation and rapid economic growth leads to higher levels of employment, rising household income, and fast-paced social evolution. One of the most significant social factors is the shift occurring at the dinner table in these markets. Billions upon billions of people are spending their improved incomes on a better standard of living, and the benchmark has been set by the ultra-high calories, protein-based diet of the west.

In order to truly understand the impact of this sea change in eating habits and appetite, we must first understand what this growing weight of demand means at a practical, production level. Whilst the traditional indigenous diets in many of these markets is predominantly grain-based, the new standard to which they aspire is based on animal protein and higher value crops. In China, for example, per capita consumption of pork has increased from around 5kg in 1960, to around 35kg in 2010. Multiply that across 1.34 billion people and that's a lot of swine.

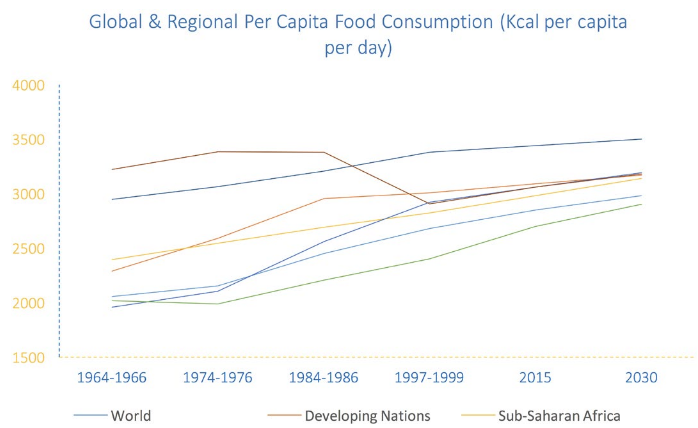
According to the UN FAO, consumption of animal products per capita in industrialised nations will increase modestly from 825 kcals per person per day today, to just fewer than 900 kcals per person per day by 2050. Yet in East Asia meat consumption is expected to rise from around 400 Kcals per person per day to around 625 Kcals per person per day, an increase of over 56%. Meat consumption in South Asia meanwhile is expected to double from 200 Kcals to 400Kcals.These are all huge populations that will apply continual upward pressure to demand for food, and the resources required to produce it such as viable agricultural land and water.

This is a much more significant issue than one might initially think. Whilst livestock production has historically been supported by grazing and crop/food waste, the increasing demand for meat has led the global livestock industry to become increasingly reliant on grain as a primary livestock feed. According to the United States Department of Agriculture (USDA), in modern intensive livestock farming where the majority of feed is grain based, 7kg of grain are required to produce one kilogram of beef. On a global average basis, given that part of the production is based on other sources of feed, such as grazing land and organic waste, 3 kg of grain is required to produce 1 kg of meat.

As meat production now depends on grain as a key input, any increase in demand for meat results in an acceleration of demand for arable and grazing land area. At least 35–40% of all cereal produced in 2006 was used as feed for livestock. This leaves an estimated 43% of cereal production available for human consumption after losses from harvest, post-harvest and distribution are taken into account.

Aside from meat, high value commodities such as berries, nuts, and other foods, especially those with perceived or proven health benefits, are also in high demand amongst the emerging middle classes. Whereas most of these types of foods have been consumed only in developed markets totalling some 2 billion consumers, another 5 billion are now catching on, and so demand for such products is likely to continue to increase, and those producers equipped to penetrate these markets will benefit.

Ultimately, this hugely important upswing in demand for food commodities will be captured in the value of productive agricultural land essential to their production; which continues to become more important and in demand on a daily basis.



Source: WHO

Summary

More more more…

Adding to the factors discussing in part 1 of this series; population growth, urbanisation and a rapid expansion of the oldest demographic groups, we can now add rising household incomes and a super-intensive appetite for resources among 5 billion emerging global citizens to the mix. This combination of more people, more demand per capita, and a huge cultural shift to western standards of living truly creates a new-normal within the demand dynamic of the global supply chain.

> *“The problem of the price of food is structural. The growth of demand cannot be checked, in that it is coming from middle income countries demanding more quality and more quantity. High demand is here to stay.”*

Sri Mulyani Indrawati

Director of The World Bank

Demand and competition for key products, services and resources will continue to intensify. The cost of basic raw materials will continue to rise, and the assets that produce them will continue to see income streams expand in line with these inflationary pressures. This higher level of income, of course, is also reflected in the capital value of the asset. After all, an asset producing commodities priced at $2,000 per ton carries an inherent value, regardless of the performance of financial markets.

With demand-side broadly covered in Parts 1 and 2 of this series, in Parts 3 and 4 we discuss how current economic policy is impacting the global economy and free markets. How do record low interest rates play out in the performance of investment portfolios? And will the mass printing of money by central banks ultimately lead to hyperinflation or a massive crash? We also look at the supply-side economics of the global supply chain, revealing the true impact of modern living on the Earth’s natural resource base. With 10 billion people to feed, do we have enough land?

Author Biographies

David Garner – Chief Executive Officer

With a background in real estate, finance and investment, David launched DGC Asset Management Limited in 2009 alongside Wendy Brittain as DGC Business Consulting Ltd; DGC was established to provide institutional investors, family offices and HNW Individuals with access to credible asset class and risk analysis within the real-asset space, focussing primarily on natural resource properties including farms and timberlands.

David has collaborated as an Advisor on investment projects within the distressed-residential and agricultural market segments with servicing Asset Managers and Family Offices through Europe. In 2009 he led a consortium of Investors investing in a structured sale-and-leaseback of a number of farm properties in the United Kingdom which has delivered annualised returns of more than 12% since inception. In 2010 David sourced and managed a multi-client investment into two farming estates in Western Australia. These assets were held and operated for two years before being profitably disposed of in November 2012 delivering a net return after fees and local taxes of 18%.

In 2011 – post financial crisis – David led a collective of US Mortgage Bankers and Real Estate Developers in developing the Secure Income Strategy™; a real estate investment project based on the acquisition and management of single family homes in the United States. This project has since attracted over USD $28 million from US and international investors, and has grown to include over 420 individual properties in five States. The SiS project has also executed a number of profitable exits; delivering liquidated annualised returns of between 18% and 65% for investors.

David is a passionate exponent of sustainable agriculture as an alternative asset class, and has developed an investment strategy and approach designed to deliver the most attractive blend of risk and reward in this growing and exciting space. Vaccinium is an extension of David's passion for agriculture, and he believes well-managed, well-located productive farmland will be one of the safest and most profitable asset classes for two generations.

Charlie Kermer - Director of Funding and Research

Charlie began his career working with BNY analytics, a quantitative asset manager belonging to The Bank of New York Mellon, where he held responsibility for business development and conducting deep market research and analysis which was used to advise central banks and institutional investors in strategic asset allocation.

His next step was to join American Express in the Credit Risk Team where he conducted thorough credit risk analysis and consulted some of the world's largest corporations on their risk profiles and advised on strategies to reduce their exposure.

After years of conducting market research and analysis and gaining a well informed view of world markets, Charlie opted to move into the investment sector in a capital raising capacity, with a focus on hard assets. Charlie used his analytical ability to build structured property portfolios in Central London for UHNW investors and institutions across the globe.

Since joining DGC, Charlie has advised on and managed real estate and agri-business transactions equating to $45 million across North America, The United Kingdom, South America and Australasia. Charlie has built a wealth of experience working with a variety of HNW individuals and Institutions, from project creation and due diligence stage all the way through to fund raising and execution.

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