

"To put the world right in order, we must first put the nation in order; to put the nation in order, we must first put the family in order; to put the family in order, we must first cultivate our personal life; we must first set our hearts right."

Confucius, Chinese philosopher

Interesting letter by John Mauldin, one of the US's top investment advisors – recently voted second only to Warren Buffet as an investment guru

I start this week's letter somewhere over the Atlantic, halfway through an 11-hour flight from Frankfurt to Dallas. It has been an altogether marvellous 11 days in South Africa, speaking to over 1,000 people at 12 venues, giving a half dozen media interviews, and meeting with many individuals.

This week, I want to give you some impressions of not only South Africa, but talk a little about emerging markets in general.

Finding Value in South Africa

I realized about halfway through my recent trip that it had been sometime since I was in an emerging-market country. I have been to over 50 countries over the past 20 years, but recently most of my travels have been to Europe and Canada, with the occasional vacation trip to Mexico.

As I observed South Africa, it was forcefully brought home to me that there is more to the emerging-market story than China, India, and Brazil. There are any number of countries that are seeing robust growth and contributing to the world economy. It was reported at Davos this year that for the first time the developing world has a larger share of world GDP than the developed world. Today, we focus on an emerging-market country that does not make as much news as it should.

As I mentioned above, the mood among those I talked with in South Africa in the early 1990s when I was travelling often to South Africa was quite pessimistic. The economy was not good, due to international economic sanctions stemming from worldwide protests over the policy of apartheid. Changes and elections were coming, and it was not clear what would happen.

I travelled for (mostly) business into 14 other sub-Saharan countries in Africa. With a few notable exceptions, most countries were not doing well and things had progressed from bad to worse over the previous 10-20 years. It was a tough time to try and do business, but it was a great education.

The contrast today is amazing. Before we get into some facts, let me give you a few impressions. First, there are construction cranes everywhere in the four cities I visited: Johannesburg, Pretoria, Durban, and Cape Town. Twelve years ago the thirty miles from Johannesburg to Pretoria was mostly agricultural land. Today it is one big city, with offices, malls, and homes lining the freeway. There was a significant number of rather nice new housing developments, many if not most being built on speculation all along

the freeway.

Johannesburg is a world-class city, on a par with New York or London or any major city in terms of facilities, shops, infrastructure... and traffic. There were new shopping malls all over, and the stores were busy. The restaurants were excellent. The hotels I stayed in and spoke at were excellent and modern. The Sandton area is particularly pleasant.

Durban is a tropical jewel on the Indian Ocean. Again, there was construction everywhere - a green, verdant city of 1,000,000 people, with modern roads and great weather.

I have been to Sydney, Vancouver, and San Francisco. I love all of them. But for my money, Cape Town is the most beautiful city I have been to in the world. Amazing mountains, blue water harbours, white sand beaches, with wineries nestled in among the mountains and valleys. The Waterfront area, where I stayed, is fun and vibrant. Again, an amazing amount of construction everywhere, especially in the waterfront area, as investors from Dubai are pouring huge sums of money into creating a massive residential/business/ retail/restaurant development. There are several similar, quite large developments going up in different parts of Cape Town.

I ate dinner on Friday night at a restaurant called Baia at the Waterfront. I find I really love the better South African chardonnays. My friends know I am something of a chardonnay snob. I like the better California wineries. I was pleasantly surprised to find more than a few South African chards the equal of their US counterparts, but at a third to half the price for the same level of quality. (I should note that a decent chardonnay in London or Europe is twice the US price.) The two of us had the best chardonnay in the restaurant and one of the better meals I have had in a long time, and the bill was less than \$100.

The next day my partner Prieur du Plessis informed me that Baia was one of the most expensive restaurants in town. By way of comparison, you can easily spend 2-3 times that at a comparable restaurant in Dallas, and 4-5 times that in New York. Forget London.

I began to ask about the bills for food, drinks, and such for the rest of the trip. The country was uniformly about half what I would pay in Texas for the same quality. I stayed in a very nice five-star hotel (The Commodore) for six nights for less than \$1,000, including several meals, laundry, and my bar tab. Their walk-up price was much higher, but clearly you can get deals, and it is tourist season at that. The service was terrific and uniformly delivered with smiles. The exceptionally nice private game reserve (Itaga) we stayed at when I first arrived, trying to get over jet lag, was only a few hundred a night, including meals, wine, and game runs. In short, after having been to London and Europe for my last few overseas trips, South Africa seemed like a bargain.

And it was not just the people I spoke to that were optimistic. **Grant Thornton (a large international accounting firm) did a survey in the 30 countries in which they do**

business. The four countries with the most optimism and confidence were India, Ireland, South Africa, and Mainland China. Why such confidence? I think there are several reasons. The economy has been growing at a reported almost 5% a year for the past several years, which is quite strong. They have had 32 consecutive quarters of positive growth. But the official figures may understate the reality by a significant amount. If you look at the VAT (value-added tax) receipts, as well as other tax figures, some economists estimate the economy may be growing by 7% or more. Why the difference?

There is a large "informal" economy in South Africa. While much of the income may not be reported, when something is bought and sold in the retail sectors, taxes are collected.

The stock market has grown by over 25%, 47%, and 41% for the last three years. Such a bull run is always a boost to confidence. But there are also some real fundamentals underlying the emerging-market Bull markets. South Africa has a strong commodity sector, with numerous commodities and not just gold. JP Morgan thinks that earnings growth for South African companies, even adjusting for some anomalies, will be 20% this year, which should mean another good year for their local markets.

This link between commodities and stock market prices is reflected not just in their stock market, but in emerging markets worldwide. Look at the close correlation for the last ten years between the prices of commodities and the emerging-market equity index. I think this rather clearly shows the link between the recent rise in commodity prices and emerging markets. It is more than just a China story.

Football as an Economic Driver The attention paid to football (or soccer in the United States) is rising to fever pitch in South Africa. And for good reason: they will host the World Cup in 2010. **They expect some 3,000,000 fans to show up. The government is using the occasion to spend some 400 billion Rand (a little over US \$50 billion) on all sorts of infrastructure projects.** They are doubling the size of the major airports, which had already been significantly improved. Walking past the construction at the Johannesburg airport, you have to be impressed with the size of it. New roads and other forms of infrastructure are being added to prepare for the influx, but it will have the added effect of making the country more competitive, just as infrastructure in China has been a boost to that country, and a lack of infrastructure has limited India.

The World Cup will also be a boost to tourism, already one of the most important sectors of the economy. Cape Town is becoming an international destination for vacations and conferences. **The growth in tourism has been strong, showing 20% growth last year from 2005. 2006 was a record year.**

Interestingly, 75% of the traffic reported in the tourism growth is from Africa and the Middle East. While a lot of the people are vacationers, I think a goodly portion are businessmen and women from all over sub-Saharan Africa who look to South Africa as a deal-doing financial centre. South Africa has a quite strong, very competent, and

growing financial services sector that is a magnet for entrepreneurs from all over Africa seeking to find capital. South Africa also has a strong entrepreneurial class which is the base for much of the new business and development, not just in South Africa but in all of Africa. The rest of the world rightly sees South Africa as the place to launch into the rest of Africa.

Are there problems in South Africa? Of course, and some of them are quite serious. But that is the case in nearly all (I cannot think of an exception) emerging-market economies. While the overall crime rate is dropping, it is still far too high. Some rather high-profile crimes of late have resulted in a strong outcry for serious change.

Corruption is an issue, but that is the case in almost every emerging-market country. The high levels of poverty are evident. Although employment is growing and more and more of the poor are being brought into the economy, there is still a lot of room for progress.

The telecommunications infrastructure is hampered by a lack of serious competition. Access to the internet is limited in many areas, and it is really slow where it does exist. This will improve in the coming years, but it is a serious handicap to business. There are power shortages and the need for more power-generation plants to keep up with the growth.

But all these areas are (mostly) going to improve. I see a lot of opportunity in South Africa in particular and Africa in general. Let's look at one area where there may be more than a little potential in the future.

I think there is deep long-term value in African (not just South African) farmland. Right now, given the nature of US and European subsidies to agriculture, it is hard for developing-world farmers to compete. But that will change in the next decade.

As I have written before, "Old Europe" the US and even Australia are going to come under intense government budgetary pressure due to the high levels of pension and medical costs they have promised their retiring boomers. Europe is particularly vulnerable. Quite simply, Europe cannot afford to keep the pension promises they have made and pay for any other normal government expenses without raising taxes. Except that they already have economy-stifling high taxes.

Budgets are going to have to be cut in other areas. At some point, sooner rather than later, agricultural subsidies are going to come under pressure, as politicians must decide where to find the money to pay for the promised pensions and health care. There are more voters who are older and on pensions than there are farmers. I can count votes, and it is not hard to predict the result. It will be with a lot of fighting, but in the medium run, the agricultural subsidies in Europe are going to have to go.

When the writing is clearly on the wall, Europe will start to negotiate on those subsidies, trying to get something for what they will have no choice but to give. Part of that will be

to reduce US subsidies as well. **Africa will become a breadbasket for much of Asia.** With China pressed for water and much of its agricultural land being used for development, China will need to import more food. And as the rest of the world becomes more developed, there will be an increased demand for meat, which means an even bigger demand for feed grains for livestock. The growing use of ethanol is increasing demand for corn, absorbing more of the world's land use for energy corn rather than for food.

The simple fact is that as the world grows more prosperous we are going to need more grain and other foods. Where is the land we are going to need to feed the world There is an abundance in Africa, along with the needed water and labour. And as African countries upgrade their infrastructure, it will improve the ability of farmers to get their grains to market at profitable levels.

There is much to like about emerging markets. **That is where a great deal of the real potential growth in the coming decades will be. And South Africa will be one of the better stories.** If you are not doing business there already, you should ask yourself, why not?

Home Again, Tulsa

I want to give special thanks to my South African partners Prieur du Plessis and Paul Stewart and the rest of the team at Plexus Asset Management. I have never been treated so well on a trip. They made all the hard work a pleasure, taking care of a thousand small details so I could focus on the tasks at hand. And they did arrange for some fun, relaxation, and great sightseeing. I am looking forward to going back soon. I was particularly impressed with South African Air. Very comfortable business-class seats, impeccable service, and great wines. I have trouble sleeping on planes, but I could actually sleep in these seats. But it still took over 40 hours to get to Johannesburg, rather than under 20, so I was exhausted when I got there. Jet lag this trip was as bad as I have ever had. Coming back has been easy. It is getting late and time to hit the send button. Have a great week and enjoy the ones you're with.

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