

STEPHEN GREEN, HSBC'S "SAGE BANKER", SPEAKS ON GLOBAL SHIFT TO THE EAST

At our recent half-yearly investment lunch, Saunderson House Chief Executive, Nick Fletcher, interviewed Stephen Green, Group Chairman of HSBC Holdings plc. In addition to some general background, the discussion explored Stephen's views on the opportunities and challenges presented by the shift of the global economy to the East, a subject that has been looming large in our minds in recent times.

[CLICK HERE TO VIEW STEPHEN GREEN'S INTERVIEW WITH NICK FLETCHER](#)

This Special Update sets out some of the highlights of the discussion, together with our views on the implications for markets and portfolios. If you are interested in reading more of Stephen Green's thoughts, [we would be delighted, on a complimentary basis, to offer you a copy of his book.](#) Please email green@saunderson-house.co.uk with your contact details and we will send you a copy.



Nick Fletcher welcomes Stephen Green.

STEPHEN GREEN'S VIEWS ON:

(i) The Shift to the East and the Financial Crisis

- While the Western banks were important contributors, the roots of the credit crisis can be traced to the global financial and trade imbalances that built up before 2007. The rising economies of the East thrived on rapidly growing exports, high savings rates and growing foreign exchange surpluses. The developed West, by contrast, was over-consuming and became increasingly over borrowed.
- Rapidly rising Eastern exports suited both East and West for a time. In the East, it facilitated rapidly rising urbanisation and income growth. In the West, it suppressed inflation and gave consumers access to cheap goods.

- Trade imbalances, of course, cause matching financial imbalances. A flood of liquidity arriving in Western capital markets, from the East's reinvestment of foreign exchange surpluses, helped inflate the credit bubble.
- As asset prices overheated and began to correct, the credit bubble collapsed. The effects became apparent initially among highly leveraged banks, which, as liquidity began to drain away, were unable to access short term funding.

(ii) Management of the Credit Crisis and Financial Reform

- In contrast with the 1930s, the response to this financial crisis, which included (i) internationally coordinated action to rescue the global financial system and (ii) Keynesian fiscal stimuli to support the real economy, will go down in history as a great success.
- The G20 group of major economies, which now includes among other developing nations China, India, Brazil and Russia, is an excellent example of the world coming together to address the crisis and agree a better way forward.
- Looking ahead, five weaknesses of the financial system (which combined to deepen the crisis by allowing the creation of more and more debt) will need to be addressed by politicians and regulators. These are (i) the accounting principles applied to the banking sector, (ii) bank capital requirements, (iii) bank leverage, (iv) compensation policies within the financial sector, and (v) the role of financial regulators in monitoring the financial system.
- Underlying all of this is Stephen's view that short-term shareholder value maximisation is not a sufficient guiding principle for business. Instead, businesses need to be managed on a much longer term basis, with more consideration given to customers, employees and the wider community.

(iii) The Continued Shift to the East

- The shift in the world's economic centre of gravity accelerated through the financial crisis. This shift is likely to continue uninterrupted and will be one of the defining features of the first half of the 21st century.
- The development of China, India and others should not be viewed with surprise. For many years, as little as 10% of the world's population produced and enjoyed the fruits of c50% of the world's economic output. This is now changing.
- The newly developing nations aspire to similar standards of living as those enjoyed in the West, and the latter must simply adapt to accommodate them.
- The now rising Eastern nations are following a similar path to that trodden by Japan in the 1950s and 1960s, with rapid growth in exports driving strong economic growth. However, as personal incomes increase in the East, these economies should become better balanced, with higher consumption making a greater contribution to the economy.

SAUNDERSON HOUSE INVESTMENT INSIGHTS

From an investor's perspective, the likelihood of continued strong economic growth in the Eastern and emerging economies presents both opportunities and challenges as follows:

- Firstly, there is an opportunity to participate in future strong earnings growth of emerging markets businesses and in the development of a consuming class in these nations.
- Secondly, an important part of the global rebalancing, and of the West's accommodation of the newly developed nations, will include currency adjustments. Higher exchange rates for countries such as China, potentially, add to the attractions of emerging markets investment.

The attractions of the emerging markets are therefore apparent. However, we should also remain mindful of the challenges. We have written previously about the need for investors to make full allowance for the reduced transparency, weaker corporate governance and less well-defined legal structures in emerging markets. A further challenge is valuation; we need to remain focused on attractively priced assets and resist compromising our value investing principles. At Saunderson House, we will be keeping this at the front of our minds as we consider further asset allocation shifts to the East in future.

This note is for general guidance only and represents our current understanding of law and HM Revenue and Customs practice as at 5 August 2010. We cannot assume legal liability for any errors or omissions and detailed advice should be taken before entering into any transaction. The value of investments and any income therefrom can go down as well as up and you may not get back the full amount you invested. Levels and bases of, and reliefs from, taxation are those currently applying but are subject to change and their value depends on the individual circumstances of the investor. Saunderson House Limited is authorised and regulated by the Financial Services Authority.