Mega Trends & Their Impact

The rate of change the world is experiencing is unprecedented. To understand why, we need to focus on Megatrends: powerful socio-economic, environmental and technological forces that shape our planet. The digitization of the economy, the rapid expansion of cities and the depletion of the Earth's natural resources are just some of the structural trends transforming the way countries are ruled, companies are run and people live their lives. For us, two of the most present and influential business megatrends shaping global industries are the unprecedented evolution and adoption of: 1. Information & Technology (I&T) and 2. The "Sharing Economy".

While many investors look at these trends in isolation and try to apply them individually to investment opportunities, we at BigSur are taking a more integrated approach to analyzing how megatrends can create value for investors. We believe that there's a "supra" trend, or a combination of megatrends at play through Corporate Concentration. Corporate concentration is the acquisition and consolidation of diverse companies under a single umbrella. This is because only a select group of giant "super star" companies can capitalize on multiple mega-trends, as they have learned how to combine the advantages of size with the virtues of entrepreneurialism. They have both the ability to deploy extensive amounts of cash and the specialized knowledge needed to capture these trends and bring them to profitability. Tech titans such as Mark Zuckerberg (from Facebook) and Larry Page (from Google) are expanding into more and more industries as technology transforms everything that it touches. Just as General Electric diversified into everything electrical, Google is diversifying into everything information-based.

What are Megatrends?

Our colleagues from Pictet Asset Management point out that focusing on megatrends has not only proved invaluable during times

The Thinking Man's Approach

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Megatrends are a discrete group of powerful social, demographic, environmental and technological forces of change that are reshaping our world. In today's market environment, where investors are hyper sensitive to short term movements, we think it's important to focus on long term trends that are going to shape global businesses in the future.

In this month's Thinking Man, we discuss what megatrends are and highlight a few key megatrends that we believe will be incredibly impactful in the future of all global industries. Finally, we discuss an overlay trend of consolidation and those companies who will be able to leverage multiple mega trends.

For more on how we are positioning our portfolios, please contact your investment advisor or email:

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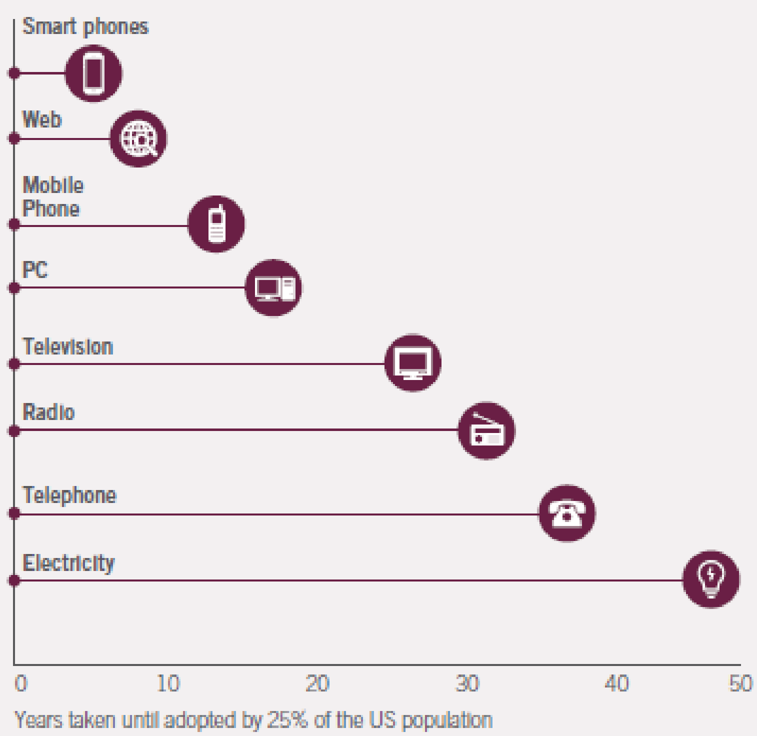
of financial and economic uncertainty and change – it has also been a source of investment success. Megatrends are a discrete group of powerful social, demographic, environmental and technological forces of change that are reshaping our world. These trends evolve independently of the economic cycle, and while they may develop in different ways and at a different pace, they each possess the capacity to redraw the financial landscape over the long term (see Fig 1 on the next page). The Copenhagen Institute of Future Studies points out that when human beings develop new technologies and forms of economic organization, we are also creating new modes of organizing society.

Megatrends may emerge from or be accelerated by financial crises, shifts in the social realities that define the marketplace, or the threat of conflict over resources. The Cold War drove the innovations that launched both the space race and rapid developments in the field of microelectronics—ultimately unleashing the I&T megatrend. Electrification, the rise of mass production, and globalization were also megatrends. The common thread among them is that they presented inescapable strategic imperatives for corporate leaders. Corporations must recognize the megatrends and position themselves to adapt. If they fail, they die.

Fig.1 - Forces with the ability to impact society, the economy and our lives

Reference: Copenhagen Institute of Futures Studies

Fig.2 - Technology adoption rates are increasing rapidly



Reference: US Census, Wall Street Journal

Figure 3: Key Global Megatrends

- NETWORK ECONOMY
- SUSTAINABILITY
- KNOWLEDGE SOCIETY
- IMMATERIALISATION
- DEMOCRATISATION
- ACCELERATION AND COMPLEXITY
- TECHNOLOGY DEVELOPMENT
- ECONOMIC GROWTH
- INDIVIDUALISATION
- COMMERCIALISATION
- GLOBALISATION
- POLARISATION
- FOCUS ON HEALTH
- DEMOGRAPHIC DEVELOPMENT

Source: Pictet

In today's market environment, we see investor's losing sight of long term trends and where the world is shifting in the next few years. By taking a step back from the short term noise, and thinking about the megatrends that are shaping our society, we can find investment opportunities for the long term.

Key megatrends: Technological Development & Sharing Economy

A key megatrend we focus on is technological development, or the unprecedented pace at which technology is now evolving. Figure 2 above shows how much quicker technology is reaching the masses: while it took nearly 40 years for 25% of the US population to get telephones, it took about 5 years to reach this level of adoption for smart phones. Technology is being adopted quickly and is shaping every global industry. For example, in the auto industry, this trend manifests itself in a number of ways, most obviously via the development of self-driving and electric vehicles being developed by Tesla. In the defense industry, the use of drones and advancements in cyber security are reshaping how companies create their products and services to an expanded client base.

The Internet of Things is perhaps the most powerful way technology is being adopted. You can speak into a wearable device to voice control your television or the lights in your house. You can check in with your washing machine and it will reply back to you what cycle it is in; your refrigerator can text you how many eggs you have left, and your robotic vacuum would tell you the last time it cleaned.

The Internet of Things (IoT) and its expansion will give a powerful push to even more consolidation amongst those companies who are leading its adoption. Gartner, Inc., a leading technology research firm, predicts that the number of products connected to the internet will increase from 6.4 billion today to 21 billion by 2020 as companies discover the power of software.[1] The process has already begun. Coca-Cola uses microchips to track its bottles. Tesla improved its cars' uphill starts by transmitting a software update. General Electric thinks that the IoT will be the biggest revolution of the coming decades. The increasing convergence of hardware and software lets companies establish much closer relations with their customers. They can gather information in real-time on the response to their products and use it to make improvements. They can tailor products to the needs of individual customers.

A second megatrend shaping all industries is the growth of the Sharing Economy – the increased interconnectedness of individuals and businesses that is enabling the speedier transfer of goods and services from provider to receiver. These companies typically rely heavily on mobile technology, and create attractive offerings for customers by making them highly convenient and cost efficient. The car sharing service Uber is probably the most well-known, although over the last few years, there has been a boom of Sharing Economy companies in all types of different markets. Spotify and Apple are taking over music in the Sharing Economy; companies like Uber Eats, Amazon Now, and Grub Hub are all offering quick food delivery; and even professional services are starting to adapt in the legal space (Quick Legal) and medical care (Medicast).

The Sharing Economy uses advancements in technology to capitalize on the most fundamental parts of human nature: networking and communication. This has emerged as a megatrend because network has become a central term that permeates our way of thinking and how companies conduct business. Those companies who do not integrate this megatrend in their strategy will likely be left behind.

Technological progress and the network economy are just two of the many megatrends that will have a profound effect on the interactions between individuals, organizations and the environment over the years and decades to come. See figure 3 on the left for more examples. We do highlight these two trends, however, as we believe that they are two of the most impactful and transferable to profitability. It's easy to identify companies that are capitalizing off of technological progress and the network economy – and who are the industry leaders.

Mega Sized Companies Dominate

Industry leaders take advantage of "supra trends" through Corporate Concentration. This select group of "Super Star" giant companies have the means and ability to capitalize on multiple global mega-trends.

When evaluating the global corporate landscape, it's clear that the consolidation, power and success of mega companies has increased over time. The McKinsey Global Institute, calculates that 10% of the world's public companies generate 80% of all profits.[2] According to researchers from Rice University, firms with more than $1 billion in annual revenue account for nearly 60% of total global revenues and 65% of market capitalization. Sales by the median listed public company are almost three times as big as they were 20 years ago. Profit margins have increased in direct proportion to the concentration of the market. So did the cash reserves on the balance sheets.

Startups, meanwhile, have found it harder to get off the ground. The Brookings Institution notes that the number of startups is lower than at any time since the late 1970s, and that more companies die than are born, pushing up their average age. The number of startups and IPOs in America remains at disappointingly low levels.

The superstar effect is most visible in America, the world's most advanced economy. The share of nominal GDP generated by the Fortune 100 biggest American companies rose from about 33% of GDP in 1994 to 46% in 2013. The number of listed companies in America nearly halved between 1997 and 2013, from 6,797 to 3,485, according to Rice University, reflecting the trend towards consolidation and growth in size.[3]

Reasons that a few "Superstar" global companies can leverage multiple megatrends

There are several reasons why these companies are positioned to leverage these multiple megatrends.

- *Network Effect:* We think that the main reason these dominant companies have been able to leverage multiple megatrends is that they master the concept of "network effect". Network effects have always been powerful engines of growth: not only is success self-reinforcing but it follows the law of increasing returns. By mastering the "network effects", they can leverage multiple megatrends at one time.

- *Platforms that Interconnect, Scale:* Some network companies even pay people to become customers in order to achieve scale. And those effects become even more powerful if networks connect with each other to produce multi-sided versions. Most of the new tech firms are "platforms" that connect different groups of people and allow them to engage in mutually beneficial exchanges. Older tech companies too are putting increasing emphasis on the platform side of their business. Everyone wants to sit at the heart of a web of connected users and devices that are constantly opening up further opportunities for growth.

- *Infrastructure of the Information Economy:* This infrastructure is increasingly controlled by a handful of companies: Amazon has almost one-third of the market for cloud computing, and its cloud-services division has grown by more than half over the past year. The world's three most valuable companies at present are all tech companies, and Amazon and Facebook come in at number six and seven. Google controls 69% of the world's search activity; 90% of the operating systems in smartphones are provided by either Google or Apple.[4]

- *Supply Chains:* These dominant global players reap enormous efficiencies by creating supply chains that stretch around the world and involve hundreds of partners, ranging from wholly owned subsidiaries to outside contractors. Mr. Ghemawat, from New York University calculates that America's top 1,000 public companies now derive 40% of their revenue from alliances, compared with just 1% in 1980. We believe Costco is a master in the supply chain.

- *Regulation:* The growth in regulation has also played into the hands of powerful incumbents. Regulatory bodies have got bigger. Regulation inevitably imposes a disproportionate burden on smaller companies because compliance has a high fixed cost. Thus, the cost per employee of federal regulatory compliance is much larger for businesses with fewer employees than for large companies. Younger companies also suffer more from regulation because they have less experience of dealing with it.

- *Traditional Corporate Functions: The Economist* points out that today these tech giants look more like traditional corporations than startups. Back in the 1990s there was an open-ended and freewheeling culture full of small, nimble and fluid companies. Today the captains of new technology are replacing the freewheeling culture with the rule of a handful of corporations. They are investing more in traditional corporate functions such as sales and branding. So the valley is being corporatized: a handful of winner-takes-most companies have taken over the world's most vibrant innovation center. The region's startups are always in competition to provide the big league with services or, if they are lucky, with their next acquisition.

- *High Cash Reserves for Active Acquisitions:* With their huge piles of reserves in cash, tech giants are also continuously buying up smaller companies as part of a wider strategy of investing in their proprietary technologies. In 2012, Facebook acquired Instagram for $1 billion, which works out at $30 for each of the service's 33m users. In 2014, Facebook bought WhatsApp for $22 billion, or $49 for each of the 450m users. This year, Microsoft spent $26.2 billion on LinkedIn, or $60.5 for each of the

433m users.[5] Companies that a decade ago might have gone public, such as Nest (a company that makes remote-control gadgets for the home and was sold to Google for $3.2 billion), have found it difficult to refuse the lofty offers from these Corporate Concentrators.[6]

Conclusion

Megatrends are shaping the way we live, our future, and global industries. Superstar, mega cap companies that are able to capitalize off of multiple megatrends, especially those related to technology development and the sharing economy, are positioning themselves to be leaders of the future.

Investors interested in this theme through a more mature approach (versus a venture capital opportunity) can consider investing in some of these superstar, mega cap, public companies. For those clients who are more active in their approach to investing, and like to follow and hold individual equities, we have a list of these superstar companies. The clients that like an active management approach but do not like to hold individual companies can invest in a few mutual funds we've identified that invest in industry super stars. Finally, for clients who prefer a passive approach can invest in ETFs that are constructed to invest in industry leaders.

- Focus on some individual leaders like Google, Apple, Amazon, Facebook, Costco or Biogen;
- Buy a diversified portfolio of Global Blue Chip stocks like the *BSP Equity List*;
- Buy ETFs like the *Dividend Aristocrats in the US or IOO ETF (S&P 100 Global Index)*;
- Buy a mutual fund like *Morgan Stanley Global Brands*.

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[1] www.gartner.com/newsroom/id/3165317

[2] www.economist.com/news/special-report/21707048-small-group-giant-companiessome-old-some-neware-once-again-dominating-global

[3] www.economist.com/news/special-report/21707048-small-group-giant-companiessome-old-some-neware-once-again-dominating-global

[4] www.economist.com/news/special-report/21707051-americas-corporate-world-alternates-between-competition-and-consolidation-what-goes-around

[5] www.economist.com/news/special-report/21707050-superstar-companies-are-far-more-resilient-critics-give-them-credit-new

[6] http://www.wsj.com/articles/SB10001424052702303595404579318952802236612

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