ANNEX RESEARCH

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GLOBAL TRENDS

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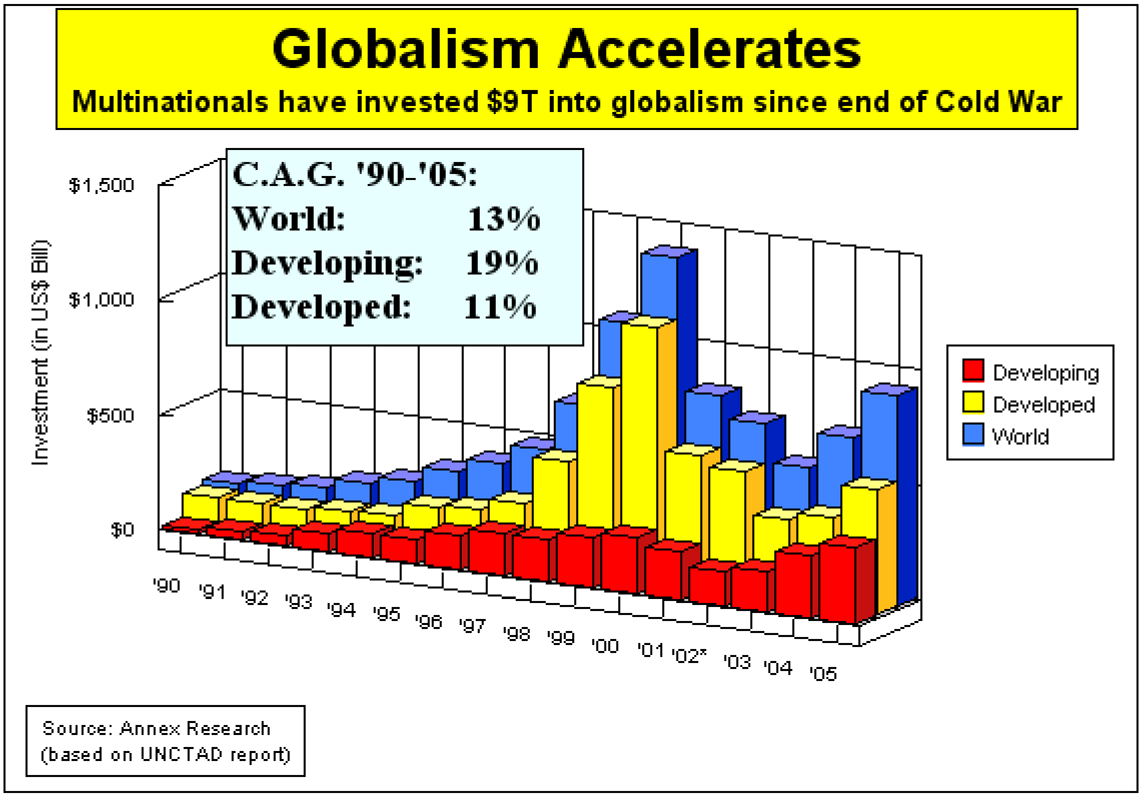
Annex Research Analysis of U.N. 2006 Annual Report on Global Investments

Globalization Accelerates

Global Direct Foreign Investments Up 29%, Driven by an 88% Surge in Cross-Border M&A's; Stock Surpasses $10 Trillion

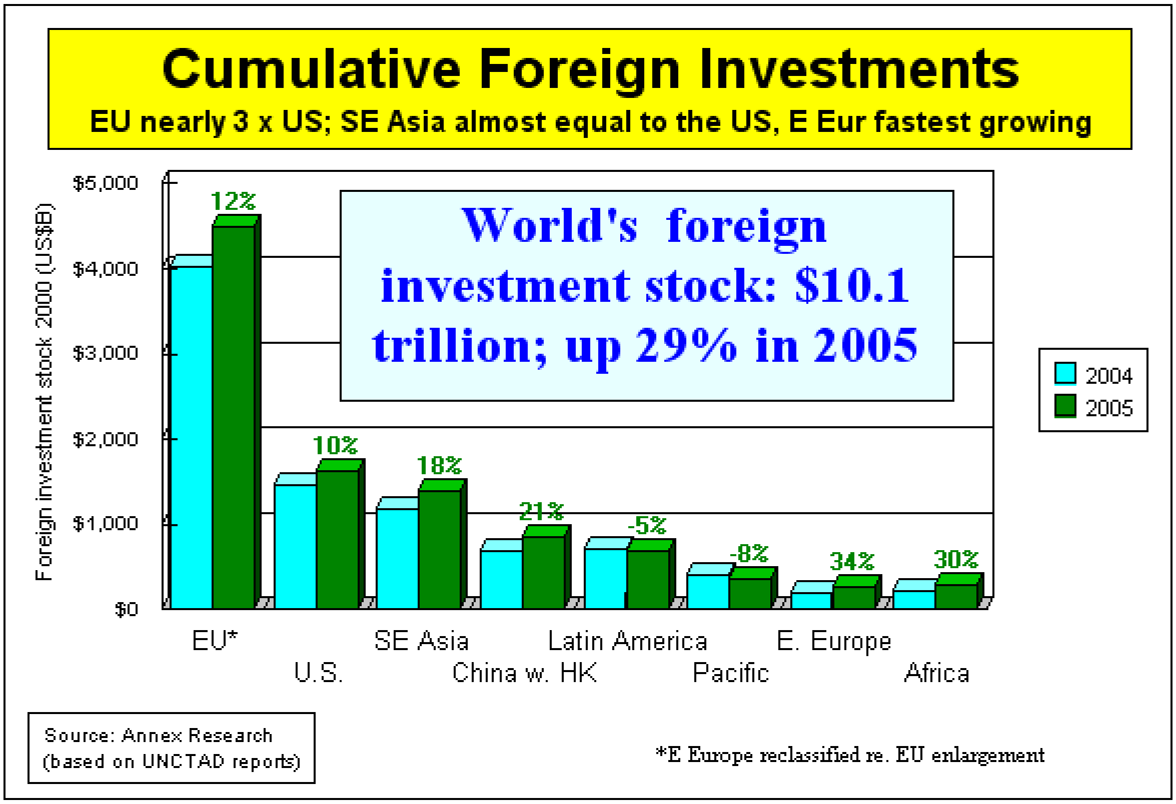
SCOTTSDALE, Dec 8 - Hold on to your seat: Globalization of the world's business is accelerating at unprecedented rates, driven by a surge in cross-border M&A's (mergers and acquisitions). In 2005, multinational companies placed $916 billion in direct investments in foreign countries, up 29% from the year before total (see "Yin Yang Pacific Tsunamis," Oct 2005).

Just as significantly, it was balanced growth. All the world's major regions, and most countries (126 of 200 economies covered by the United Nation's UNCTAD organization) received more money last year than in 2004.

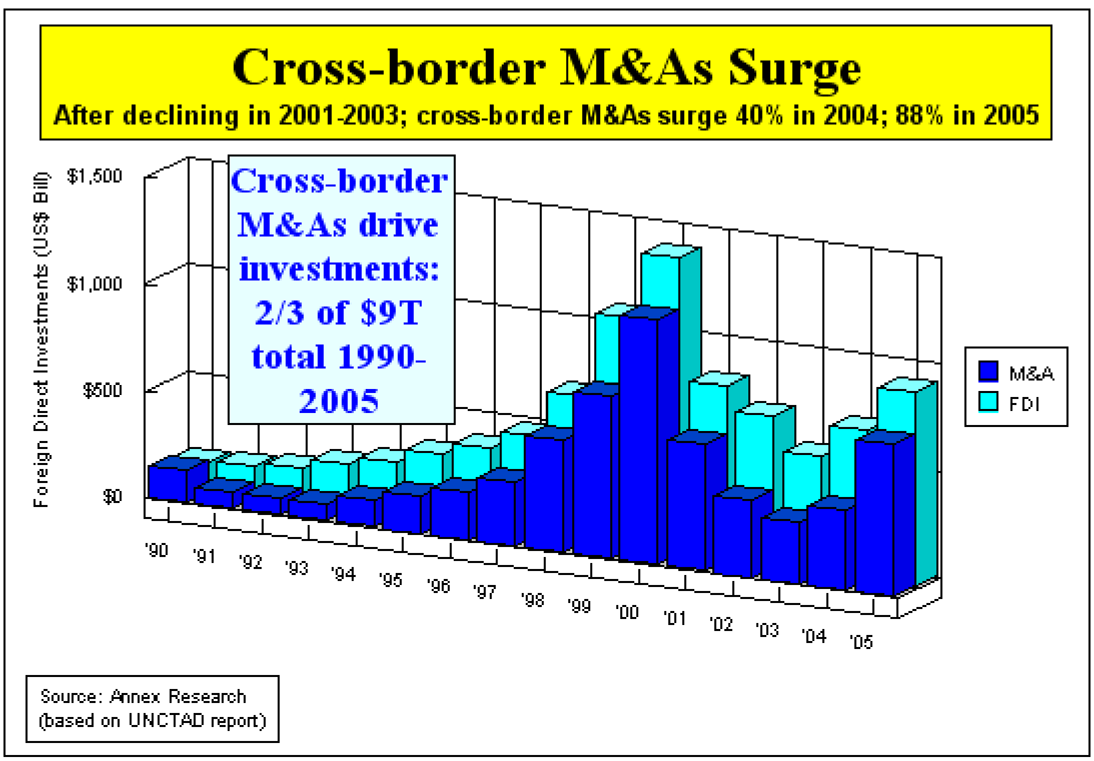


This puts the total direct foreign investments made in the 15 years since the end of the Cold War at more than $9 trillion, a compound annual growth of 13%. Within that total, investments in developing countries increased at 19% per year, while those in the developed countries rose by 11% annually during the same period.

Investment inflows to developed countries in 2005 amounted to $542 billion, an increase of 37% over 2004, while to developing countries they rose to the highest level ever recorded – $334 billion, up 22% over the year before.



All this means that 90% of the world's total foreign investment stock of over $10 trillion has been placed in the last 15 years. That's an indication of just how fast globalization has been spreading, unobstructed by the Cold War enmities.



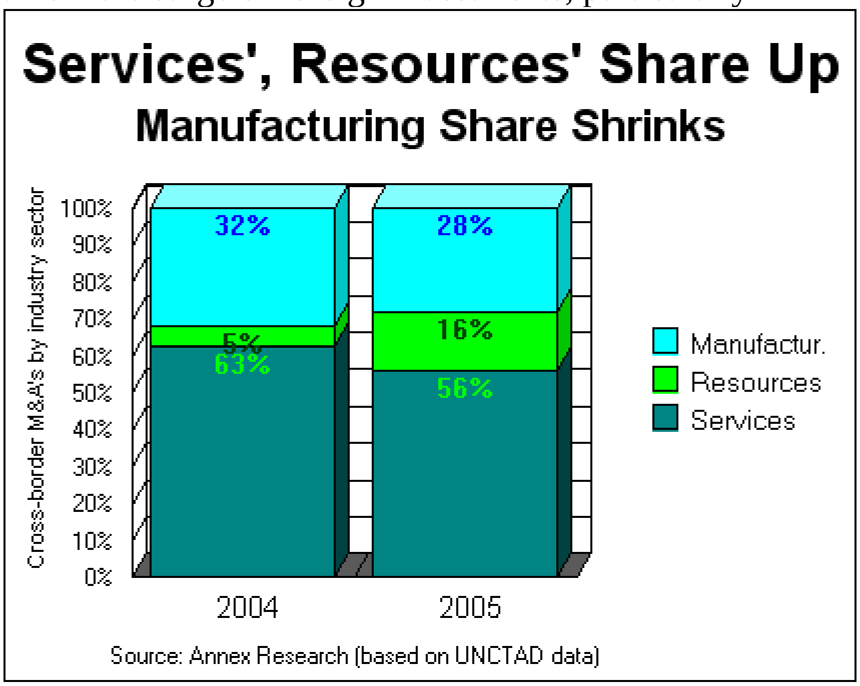
Cross-border M&A's accounted for $716 billion or two-thirds of the 2005 total, according to the 2006 report on global investments, recently released by UNCTAD.

There were 141 mega deals in 1005, valued at more than $1 billion. That's close to the peak of 2000, when 175 such deals were recorded. The value of mega deals was $454 billion in 2005 – more than twice the 2004 level, and accounting for 63% of the total value of global cross-border M&As.

Clearly, globalization is no spontaneous, grassroots event. As we have noted before, it is a Wall Street-driven trend (see "Robber Baron Era Is Back," Jan 2001). Investment bankers are using their clients - multinational companies - like pawns in the game of global market chess.

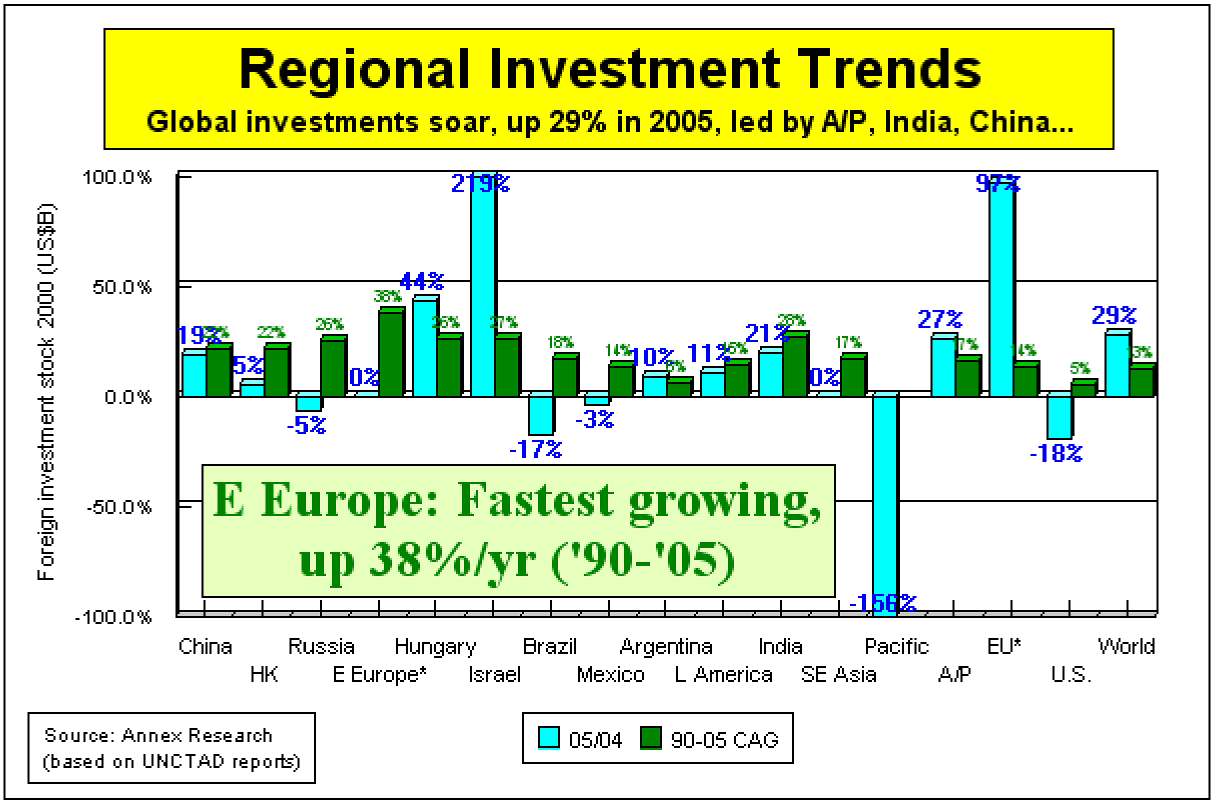
Services Gains, Manufacturing Loses Share

Services gained the most from the surge of foreign investments, particularly finance, telecommunications and real estate. Its share of cross-border M&As rose from 56% in 2004, to 63% last year. Meanwhile, the manufacturing sector's share shrank from 32% to 28% in the same period.

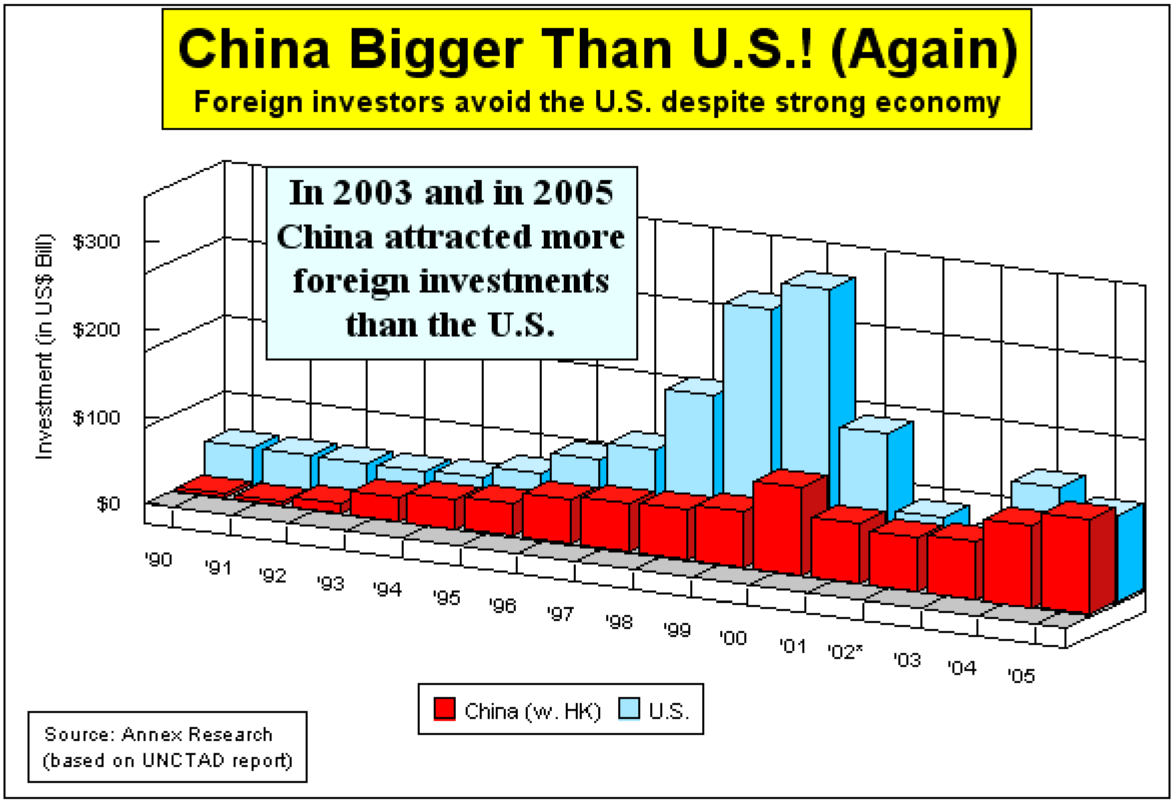


The predominance of services in cross-border investments is not new. Nor is the fact that manufacturing is losing share, except perhaps in china. What *is* new is the the sharp rise of investments into the resource sector (with a six-fold increase in cross-border M&A sales), primarily in oil and gas industry. Once again, that's due to the sudden and steep rise in world energy prices.

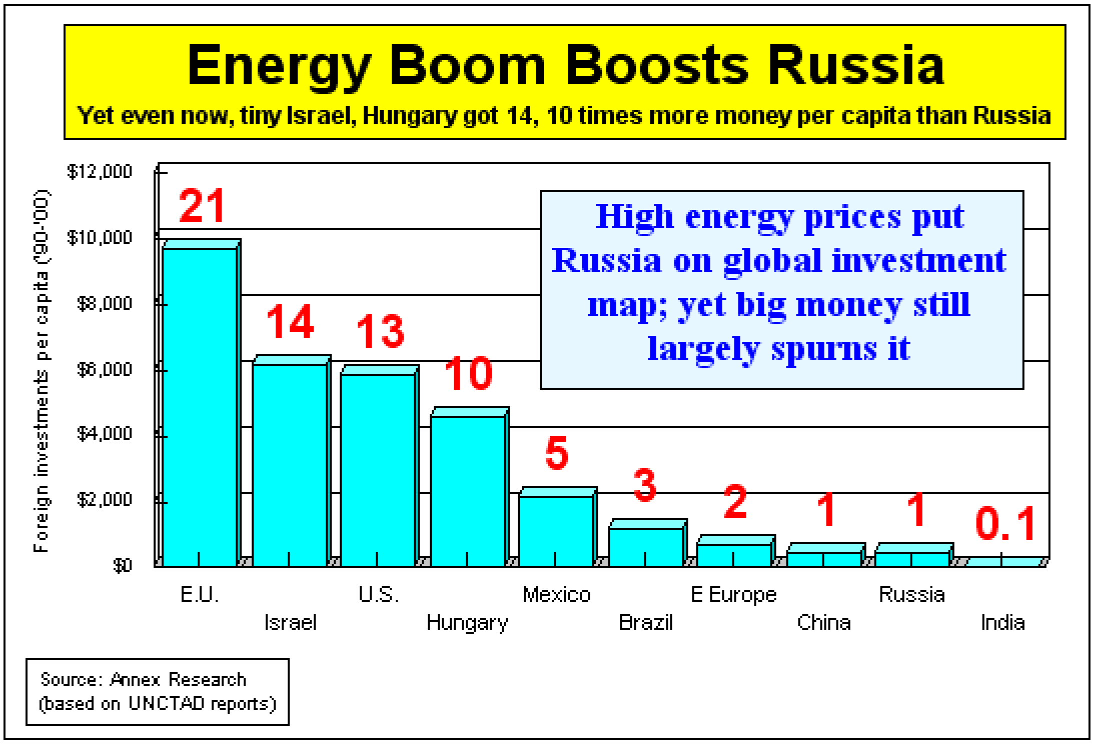
Regional Trends



World. Latin The European Union (EU) was the favorite foreign investment destination, with inflows of $422 billion, or almost half of the world total, and more than double that of the U.S. Southeast Asia was the second most popular investment opportunity, followed by Latin America and Eastern Europe (including Russia). But it was Eastern Europe that experienced the fastest growth in the last 15 years, up 38% compounded annually.



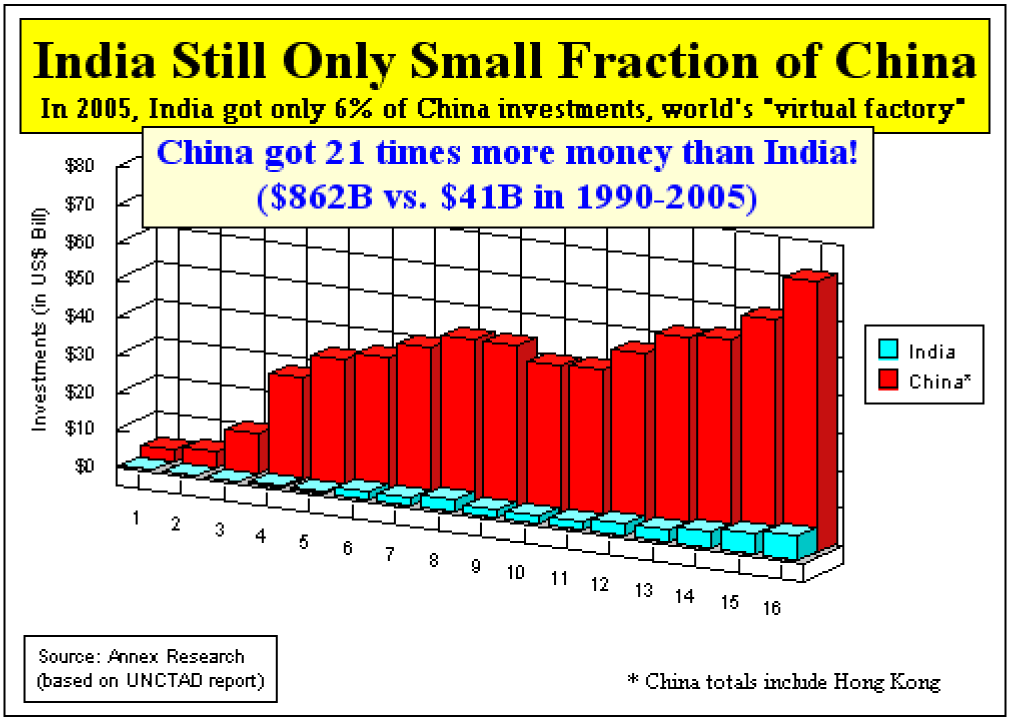
Among the top individual countries, the U.K. saw its inbound foreign investments surge to a total of $165 billion, making it the largest recipient in 2005. China (with Hong Kong), was the second largest recipient of foreign investments with a total of $108 billion. Despite a decline in the level of foreign investments (down 18%), the U.S. was the third largest recipient. It was the second time in three years that China became a more attractive investment destination than the world's largest economy.



A 92% surge in the world energy prices in the last three years finally put Russia on the global investment map. With about $15 billion in foreign investments in the last two years, Russia now ranks alongside Brazil and Mexico, for example, long-time favorites of investment bankers. But on a per capita basis, Russia is still well below the investment levels of some of the much smaller international players. Tiny Israel and Hungary, for example, received 14 and 10 times respectively more money per capita than did the world's largest and richest country (in terms of mineral resources). But the gap has closed somewhat in Russia's favor compared to the situation, say, five or 10 years ago.

An interesting sidebar from the above chart is that in 2005, Israel also outperformed the U.S. on a per capita basis as a foreign investment destination (14 to 13). The EU, on the other hand, is the world's most popular foreign investment destination, even on a per capita basis, as it is in absolute terms.

Asia. Foreign investments in Southeast Asia reached $165 billion in 2005, accounting for 18% of the world inflows. About two thirds went to China ($108 billion, including Hong Kong's $36 billion). The rest of the region received $37 billion, led by Singapore ($20 billion), Indonesia ($5 billion), Malaysia and Thailand ($4 billion each). Over half of the inflows to the region came from developing countries, mostly within the region.



Inflows to South Asia, which includes India, were much lower ($10 billion vs. $165 billion for Southeast Asia), though they grew significantly in several countries. India, the world's "help desk," got $7 billion from foreign multinationals, the highest level ever.

Which kind of helps put things in perspective. While China, the "world's factory," got $862 billion in foreign investments in the last 15 years, India, the world's second most populous country, received only $41 billion in the same time frame. That's a 21-fold advantage in favor of China!

Which only goes to show us how much more potential for expansion there is in India in the future. No wonder IT companies, such as IBM, HP, Accenture, EDS, Capgemini... etc. are all racing to spend gobs of money on staff and global service delivery centers in that country (see "A Tale of Two Blues," June 2006).

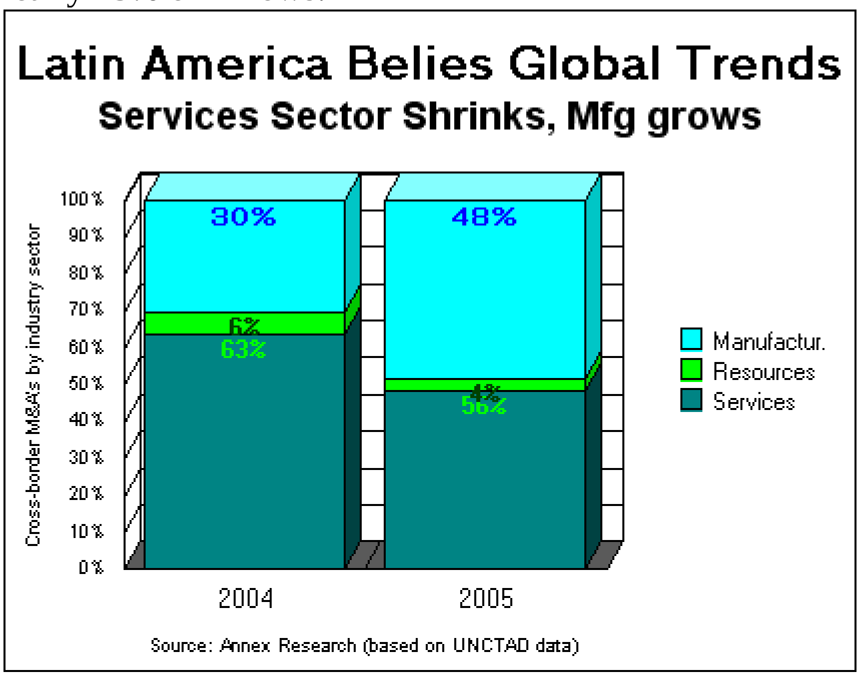
Latin America. Latin America and the Caribbean saw inflows of $104 billion in 2005, a small rise over 2004. Excluding the offshore financial centers (in the Caribbean), inflows increased by 12%, to reach $67 billion. Economic growth and high commodity prices were contributory factors.

The region registered exceptional GDP growth rates in 2004-2005, surpassing those of the world average for the first time in 25 years. Strong demand for commodities contributed to a noticeable improvement in the regional trade balance. A significant proportion of the investment inflows consisted of reinvested earnings, reflecting a marked increase in corporate profits.

Trends varied by country. While inflows decreased in Brazil (-17%), Chile (-7%) and Mexico (-3%), they rose sharply in Uruguay (81%), more than tripled in Colombia, almost doubled in Venezuela, and increased by 65% and 61% in Ecuador and Peru, respectively.

By contrast to global trends, the share of foreign investments in services in Latin America continued to decline, from 40% in 2004 to 35% in 2005 – a low share compared to world averages (see above). Some multinationals continued to withdraw from the region, in part due to disputes with host governments in areas such as public utilities (e.g. the withdrawal from Argentina of Suez and EDF, both French companies).

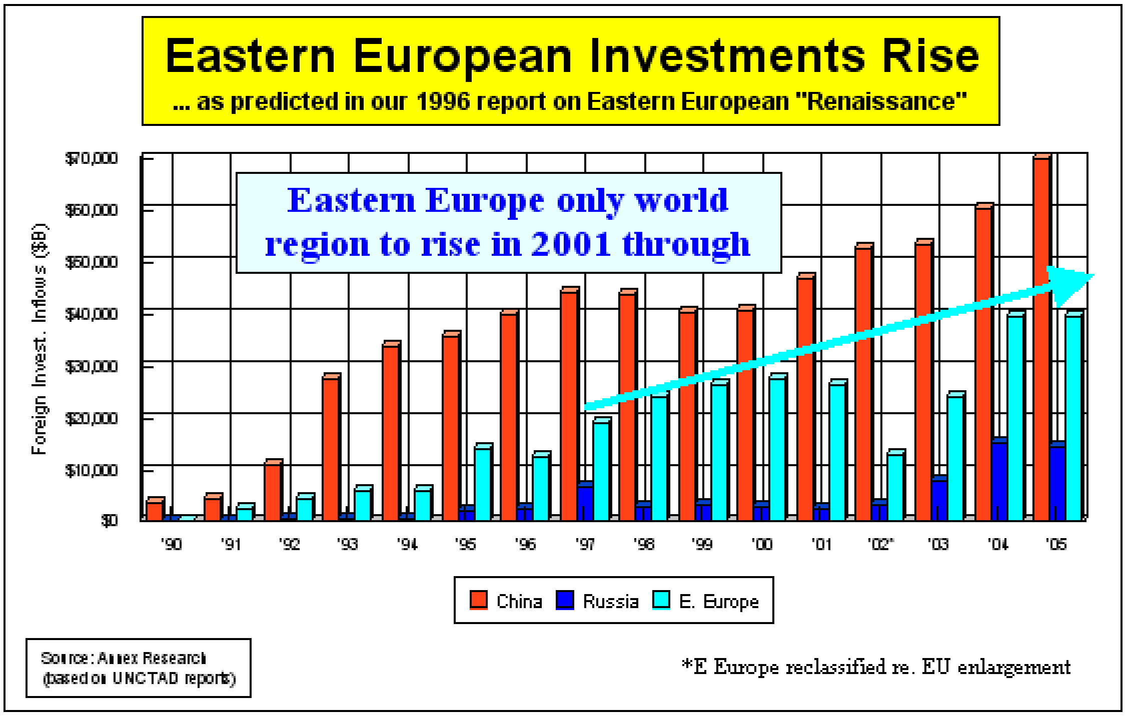
Manufacturing accounted for just over 40% of inflows, and a higher (48%) share of cross-border M&As. Even though a number of countries in the region introduced more restrictive policies, foreign investments in the resources sector grew significantly, attracting nearly 25% of inflows.



Cross-border M&As confirm the both the dominance of services, which constituted 56% of M&As in 2005, and their shrinking nature in Latin America, that belies global trends.

So it appears that Latin America is becoming the "near shore" factory destination for some U.S. multinationals that consider China either a distant market, or who may find the "world's factory" a little too crowded a shop floor for their tastes.

Eastern Europe. Foreign investments in Eastern Europe and Russia remained at a relatively high level ($40 billion). Inflows were fairly concentrated in three countries – Russia, Ukraine and Romania, in that order – which accounted for close to three quarters of the total.



Foreign investment outflows from the region grew for a fourth consecutive year, reaching $15 billion, with the Russian Federation alone responsible for 87% of the total outflows. Obviously, Russian business leaders are spending their newly acquired wealth by expanding their influence to neighboring countries.

New Global Trend: Regional Multinationals Grow

Evidently, that's a new global trend (we also noted it earlier in Southeast Asia, for example). Foreign investments from developing and transition economies reached $133 billion in 2005, which is about 17% of world outward flows. Excluding investments from offshore financial centers, the total outflow from such developing countries was $120 billion – the highest level ever recorded.

In 1990, for example, at the end of the Cold War, only six developing and transition countries reported outward foreign investments stocks of more than $5 billion. In 2005, that threshold had been exceeded by 25 developing and transition economies.

The emergence of these new sources of foreign investment funds may be of particular relevance to low-income countries. Indeed, investments from neighboring developing countries accounts for well over 40% of the total inward capital flows in of small countries. For example, in Africa, South Africa is a particularly important source of investments. It accounts for more than 50% of al inflows into Botswana, Congo, Lesotho, Malawi and Swaziland, for example - the countries that have been largely ignored by the world's largest multinationals.

Outlook

Economic growth in developed countries is expected to increase moderately, to 3% in 2006 (IMF 2006). Growth divergence among developed countries is expected to narrow. The U.S. economy will continue to be the main engine of growth, with an expected annual growth rate in 2006-2007 of 3.5%. The Japanese economy is also expected to grow this year at 2.8%, and economic recovery in the euro area should be more sustained (+2%).

Corporate profits of companies in developed countries reached historically high levels in 2005 (IMF 2006. Strong growth in world trade is expected (IMF 2006, OECD 2006). In 2006 and 2007, the volume of world trade in goods and services is expected to grow by 8% and 7.5% respectively, which would be close to the 35-year trend line and stronger than in 2005 (7.3%).

This should lead to growing investments by developed-country multinationals, both in developed and developing economies.

A Nikkei survey in October 2005, for example, revealed that 87% of Japanese manufacturing companies plan to expand foreign production over the next three years. The country that attracts them the most is China (85% of surveyed firms), followed by Thailand (23%), North America (19%) and Europe, including Central and Eastern Europe (5%).

According to an annual survey of German, foreign investments by the companies surveyed in the manufacturing sector in 2006 will continue to grow (DIHK 2006). Some 41% of the surveyed companies plan to invest abroad (slightly more than in 2005); 43% of them are planning to invest more, and only 10% less than the previous year.

Foreign investment outflows from the U.S. are also expected to increase considerably in 2006, as the massive reduction of reinvested earnings abroad – that led to relatively low outflows in 2005 – will most likely be reversed this year.

Foreign investments by institutional investors is also expected to strengthen in 2006. According to UNCTAD estimates, private equity cross-border investments in the first half of 2006 showed similarly high level as in the corresponding period last year. And cross-border M&As indicated a nearly 40% increase over the same period in 2005.

In short, hold on to your seat, globalization is accelerating. Looks like we're in for another fast ride this year, chasing the dollars, pounds, marks, rubles, yuan or yen around the world.

Happy bargain hunting!