ANNEX BULLETIN

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GLOBAL TRENDS

Updated 1/06/09, 3:10PM MST

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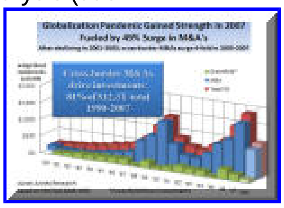
Analysis of Global Investment Trends Based on UN 2008 Report

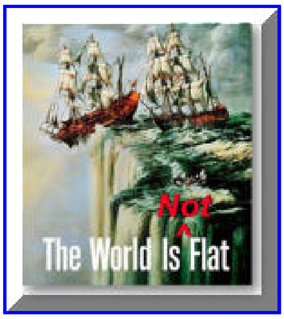
The Year of Living Dangerously

"Globalization Pandemic" Gained Strength in 2007 Before Nose-diving Last Year; A Bankers-driven Fad, Not a Grassroots Trend

SCOTTSDALE, Jan 6 – Large scope surveys are like antitrust courts. By the time they reach any definitive conclusions, the markets will have moved on, rendering the decisions inconsequential, except in terms of historical value. The annual foreign investment study conducted by the United Nations' UNCTAD branch is a case in point.

If one peruses its latest (2008) report, one would get a glowing sense of an ever-expanding "globalization pandemic," as we called it in our last analysis (see "[Globalization "Pandemic" Spreading](#), Oct 2007). Yet as we now know at least qualitatively, 2007 was the last year of living dangerously. Led by Wall Street bankers, global multinationals were spending money as if there were no tomorrow. Foreign investments were up 30% to a record $1.83 billion, fueled by a 49% surge in M&As (mergers & acquisitions). But what we can expect to see when the dust has settled on the financial storm of 2008, is a chart that will look something like the one on the right - a sharp drop in 2008 that followed four-fold increases in the 2003-2007 period.





And so, while the latest UNCTAD report keeps on glorifying the virtues of globalism, we now know better, having seen the carnage financial firestorms can produce at the ground level. In its wake lay broken dreams of surging markets. replaced by hurriedly stitched-together plans for layoffs, cost cuts and pleas for government bailouts. Which is why the cover of the book by the former Harvard Business School professor, Pankaj Ghemawat - "[Businesses Beware: The World Is *Not* Flat](#)" (left) - seems very appropriate (also see Dr. Laura Tyson's warnings in "[Dangers of Globalization](#)," May 2007).

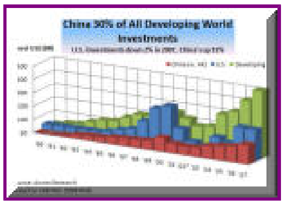
We now also know (from our past reports) that globalization is not some sort of a spontaneous event. "Trends are bottom-up; fads are top-down," noted John Naisbitt in his 1981 bestseller "Megatrends." But we have short memories. We're lucky to remember books from two years ago, let alone that far back. Which is why we are so often doomed to repeat the past.

Globalization is a bankers-driven top-down fad, not a grassroots trend. The reason this fad looks like a trend is that Wall Street has been at it ever since the end of the Cold War. Which is almost 20 years now. And every so often, after the bankers get their toes stubbed by the market place, as they did in 1995 in Mexico, or in 2000-2001 worldwide, they try and try again. Which is why that above M&A chart looks like a roller-coaster ride.

How do we know it is a bankers-driven trend? Because 81% of all foreign investments made in the last two decades were a result of M&A's, not "greenfield" (meaning direct) capital expenditures. And we know who drives and benefits the most from such buy-sell activities. Yes, in exceptional cases, principals can also benefit. But in *all cases*, bankers collect their matchmaking fees, whether or not the merged entity is a success.

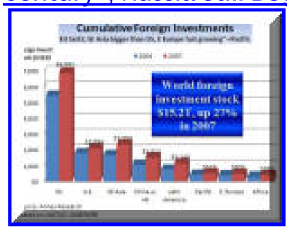
Regional Investment Trends: Eastern Europe, Russia Booming, But Brazil Takes the Cake in 2007

Whether we choose to call it a trend or a fad, globalization has been a phenomenally costly endeavor. Since we started keeping track of foreign investments, some two decades ago, the cumulative stock of the capital invested abroad has now surpassed $15.2 trillion. It was up 27% in 2007 alone.



Within that total, some may be surprised to see that the EU has attracted more than three times the capital the U.S. has during the this time frame ($6.9T vs. $2.1T). Or that Southeast Asia now ranks as the No. 2 market in the world, also ahead of the U.S. China alone represents over two-thirds of that total, and about 30% of all developing world's capital inflows (right chart).

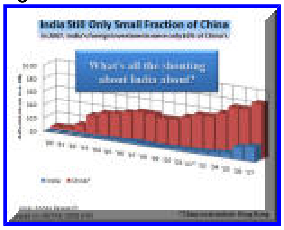
After being treated like a global orphan for much of the 1990s (see "Princes of 20th Century"; Russia Still Bogey, Feb 1996), Eastern Europe and Russia exploded with investment activities in the 21st century. They have grown at a compound annual rate of 39% to a total of over $500 billion cumulatively as of 2007. That's the kind of economic renaissance we also predicted over 12 years ago (see Eastern Europe's Renaissance II, June 1996).



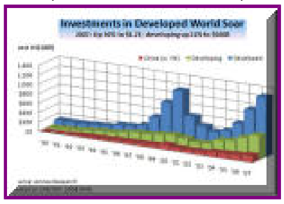
Now, Russia and Eastern Europe are growing at almost double the growth rate of foreign investments in China (21% compounded annually during the same period), a country that was the real Cold War winner, having attracted $1.1 trillion in foreign capital since the Tiananmen Square massacre in 1989. The Eastern European renaissance has been even more rapid than the foreign capital infusions in India (30% compounded annually), a country that has grabbed many headlines in the U.S. for the alleged outsourcing of American jobs to it.

And even though the Eastern Europe and Russia region was up 50% in 2007, it was Brazil that actually won the top prize as the most sought-after foreign market two years ago. It was up 84% over the year before, followed by Russia's 62% growth rate (right chart). India was up "only" 17%. The EU was up 43%.

Israel's and Hungary's declines in 2007 were only because unusually high foreign investment levels the year before. Otherwise, foreign investments in those two countries were in line with traditional levels. Which left the U.S. as the only major market that actually experienced a decline in 2007 (down 2%). That's all the more significant because of the simultaneous drop in the value of the U.S. dollar. Which made the U.S. assets cheaper when translated into foreign currencies.



As for those who are wondering what all the shouting about India was about, the world's largest democracy actually did experience a surge in capital investments, especially in the last three years. But to put things in perspective, even after that, India still accounts for only 16% of the foreign investments that China has attracted (left chart).



And China, in turn, is dwarfed by the investments that the developed countries are making in each other's markets (right chart). It is there where the bulk of the growth in the last two years has come from. Since 2005, foreign investments in developed countries have more than doubled (from $611 billion to $1.25 trillion). In 2007 alone, they were up by 33%, while investments in the developing world rose by 21%. As you saw earlier, the EU investments were up 43% in 2007.

If this trend were to continue, it would only widen the gap between the "have's" and the "have not's" in the world. Of course, that's nothing new (see "The Great Divide Widens," Oct 2008).

Summary

The "globalization pandemic" was very much in evidence throughout 2007. But it came to an abrupt halt last year. The only thing that remains to be seen when the UNCTAD surveyors collect and publish their data about the 2008 financial tsunami is by how much the global investments shrank.

With the massive spending on the Olympics in 2008, China is still likely to stay ahead of the pack in the developing world. And India's cheap labor appeal is even more appealing in a recession than in good times. So we should look for the steepest reductions in the markets that have gone up the most in the 2005-2007 period - developed countries, especially the EU and the U.S.

Alas, but the U.S. hasn't gone up that much, you're saying? In fact, it shrank even in 2007. Exactly. The financial engine of the world is being fueled by *overseas* economies. Nothing new there, except for the uninitiated. After all, five years ago, China's foreign investments were even bigger that those in the U.S. (see An Analysis of Global Investments 2003, Jan 2004). We have become the net exporters of both capital and jobs. Which is what the "globalization pandemic" is really about. But every so often, we hit a wall. Sometimes quite hard, like right now.

In short, the law of gravity applies to global economics, too: "What goes up must come down." Even the Wall Street bankers are not immune from that. Of course, in plutocracy, they can always engineer a soft landing. Enter government (read taxpayer) bailouts.

Happy bargain hunting!

Bob Djurdjevic

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