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ROBECO GLOBAL CONSUMER TRENDS EQUITIES

Key areas to watch in 2015

- Is the TV advertising market under threat?
- Strong brands need to look at multiple distribution channels
- The rise of the emerging middle class

Total consumer spending in developed markets like Europe, the US and Japan will continue to grow at a relatively slow but sustained pace. This calls for a more focused investment approach. Robeco Global Consumer Trends Equities selects long-term trends from a top-down perspective and translates them into a portfolio of companies benefiting from these trends.

The three trends selected in the fund – the digital consumer, strong brands and the emerging consumer - are longer term in nature. Below we will highlight the key focus areas within these trends that we think will be important in 2015.

The Digital Consumer: TV under threat?

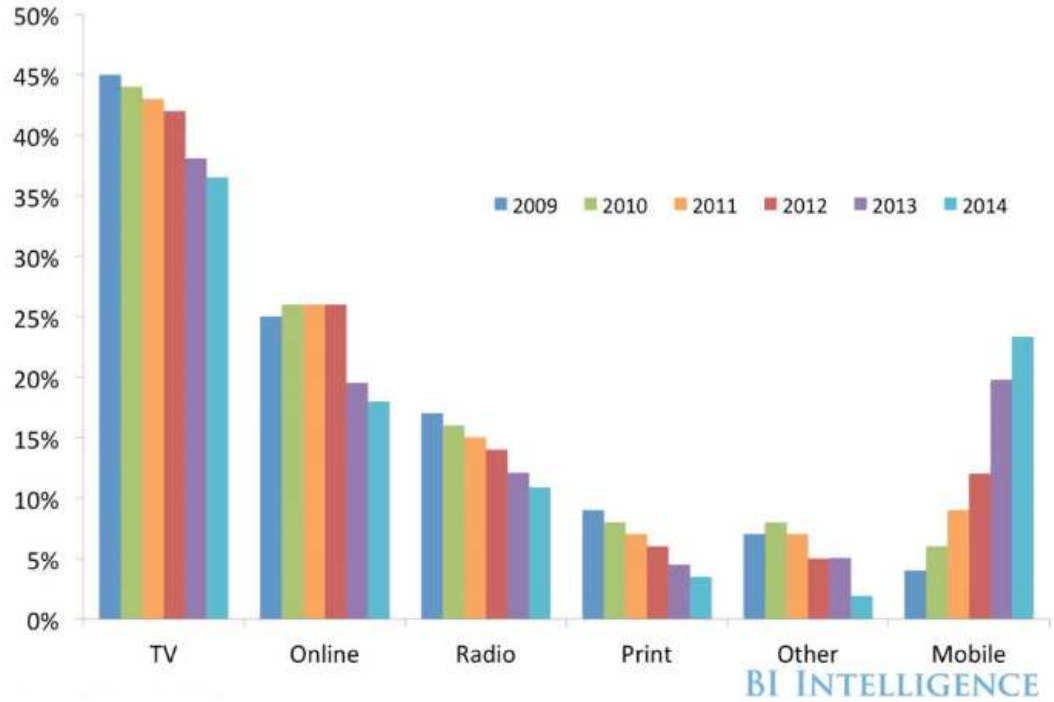
We have witnessed a secular shift in advertising away from traditional media, like newspapers and magazines, towards digital media, like web search and social media. However, TV advertising always managed to come away relatively unscathed with a market share that remained steady at around 40% (see graph below). Over the last 18 months the question whether digital is finally starting to impact TV advertising dollars was front and center for many investors, especially since some of the biggest US advertisers pulled back on advertising commitments during the so-called

'upfronts'. The upfront selling season, which allows marketers to buy commercial airtime ahead of the regular TV season, was down about 6% from last year according to the Cabletelevision Advertising Bureau (CAB). The last time this happened was during the Great Recession of 2008. US TV advertising spending did not show any growth in 2014 (adjusted for the Olympics), and younger audiences (12-34 years old) registered a 4% to 5% viewership decline!

Changing consumer habits

One of the main reasons is the change in consumer habits when it comes to watching TV. Time Warner has commented for instance that more than 75% of their megahit series Game of Thrones is NOT watched during the original (Sunday evening) airing time. This gives advertisers little incentive to secure slots ahead of the season and shifts the balance of power from the cable network owners to the advertisers. Media executives expect these advertisers to return in the scatter-market, where slots are sold closer to the air date. This is normally more expensive as less advertising slots are available but that premium has also been declining over the past years as live audiences (except for sports events) have been dwindling.

Figure 1 | US media consumption share by channel, 2009 - 2014



Source: eMarketer, April 2014

Over the top: bypassing cable

Another threat to the TV landscape and cable networks is the emergence of various over-the-top (OTT) offerings, which refer to the delivery of content over the internet without the involvement of a cable network. Besides poster child OTT offerings such as Netflix, HBO recently announced it was going to offer over-the-top streaming content to households as well. In the slipstream of HBO, CBS also announced its own streaming offering for 6 dollars a month. The question now arises whether popular networks like ESPN would be next to go over the top. This is highly unlikely as currently ESPN gets USD 6 a month from 100 million US households. Therefore, the economics of going directly to the consumer would jeopardize a multi-billion dollar income stream. This seems way too risky a proposition.

Video is something to watch

As advertising seems to be shifting away from TV, the logical direction is online. Within online advertising, video is becoming much more important. For online video, Google (YouTube) and Facebook are the go-to places. YouTube is a great Google asset which should benefit from a shift towards online video. As Facebook is starting with videos that automatically play in users' newsfeeds, future opportunities may include actual content (instead of ads) or live events that can be watched through Facebook. We believe video is something to watch in 2015 ;)

Strong Brands need to look at multiple distribution channels

Consumers have changed their purchasing behavior in recent years. Nowadays customers have little time, are multitasking, and want their needs to be satisfied immediately. This means that competition is more intense, more and more channels have to be served - and all that with steadily growing customer expectations and increasing complexity. Not to mention that in general consumers are taking over control and decide through which channel they wish to be addressed.

The consumer is taking control

Most retailers or consumer brands have grown up in a world where they decided which channels to distribute their products through. However, in this new (digital) environment the consumer decides where he or she wants to buy products.

So it's becoming increasingly important for retailers and brands to offer the same products across all their distribution channels and deliver the same customer experience. For most retailers these channels often act independently of one another, and the retailer's knowledge of each channel exists in separate technical and functional silos. Businesses' understanding of customers are also limited to each channel, and are unable to put all their customer data together in a coherent manner to understand their changing consumers.

*An integrated omnichannel approach is needed*

In this changing environment it is clear that businesses that successfully navigate these changing demands will get a strong competitive advantage and capture greater market share and profits. To obtain a unified single view of their customers, businesses need to integrate their various channels in such a way that all systems across the various channels communicate with one another. Such an integrated approach is called an 'omnichannel' approach.

So within our Strong Brands trend we look for retailers and/or brand companies that have a well developed omnichannel strategy and can therefore reach their customers across all old and new distribution channels. A good example is Nike, which integrated its mobile app, Customer Relationship Management (CRM) back-end system as well as its in-store point-of-sale (POS) kiosks to capture customer interactions and match them with transaction data. In addition, they built detailed customer profiles and pushed personalized offers to upsell customers through their mobile app, increasing sales by almost 6% with these in-store offers alone.

Inditex is another example of a multi-channel brand, especially the largest brand of the Inditex group, Zara. Zara now has an online presence in 27 countries. Zara allows your online order to be picked up in the store or sent to your home. However 70% of returns are done to their stores, as this is free of charge. This is a great way for Inditex to keep customers coming back to their stores.



Inditex also announced they will roll out a new inventory management system before the end of 2016 in all of their 2000 Zara stores. This new system ensures that the right products are in the right place at the right time. At its enabled stores, Inditex is achieving operational efficiencies through improved inventory processes.

The emerging consumer: it’s all about the rise of the emerging middle class

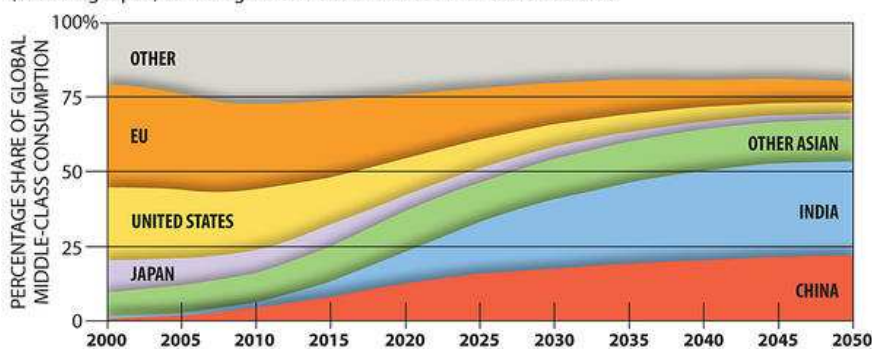
The nineteenth century industrial revolution created a substantial Western European and American middle class. Today the same is happening in emerging markets. Over the next two decades, the global middle class is expected to expand by another three billion, from 1.8billion to 4.9billion, coming almost exclusively from the emerging world. In Asia alone, 575 million people can already count themselves among the middle class — more than the European Union’s total population.

Asia’s share in the new middle to double

Rapid growth in China, India, Indonesia, Vietnam, Thailand, and Malaysia will cause Asia’s share of the new middle to more than double from its current 30%. By 2030, Asia will host 64% of the global middle class and account for over 40% of global middle class consumption. This crossover from West to East in terms of size and spending of the middle class has large implications for expected consumption growth.

The global middle-class wave

Global middle-class consumption will shift heavily toward China, India, and other Asian countries (excluding Japan) as the high-income countries see their share decrease.



SOURCE: H. Kharas (2010), 'The Emerging Middle Class in Developing Countries', OECD Development Centre Working Paper No. 285 RICH CLABAUGH/STAFF

These new middle class consumers in the East will be able to buy a wider range of goods and services, and demand for health and education services is likely to expand significantly as well. This will add to the skills of the workforce.

Adapt to shifting local demands

The aging population in China will need new financial services to help them save for retirement. In addition, the pressure from urbanization will lead to growing demand for green technologies. The transformation is most dramatic in China, but there will be shifts across many developing economies. What these households want may be very different from the consumer demands seen

in previous periods of rapid economic development. Businesses will need to tailor the products they offer to shifting local demands.

More money to spend

Over the past decades, developed economies have dominated sales of durable consumer goods. Penetration is still relatively low in many rapid-growth economies. Once household incomes approach USD 10,000, however, demand for durable consumer goods picks up. As more households in these economies move into higher income bands, they will have more money to spend on discretionary items. Demand for services such as communications, culture and recreation will grow at almost twice the rate of food spending.

However, this higher growth in consumer spending in emerging markets has not been an easy win for consumer companies. Many local companies prioritized sales growth, but intense competition, value-focused consumers and rising costs are making it difficult to boost the bottom line. Amid rising volatility, companies must be more careful and strategic in how they approach these markets.

Strong local positions or strong Western brands

This is the reason why within our emerging consumer trend we focus on companies with very strong local market positions or strong Western brands. Examples of companies with strong local market positions are Amore Pacific and Eicher Motors which are market leaders in their respective end markets, with strong local brands. AmorePacific is the leading cosmetics company in South Korea, but has become extremely popular in other emerging markets as well, especially in China, due to their strong local brand and price positioning below Western peers. Eicher Motors, with its Royal Enfield motorcycle brand, has a very strong position in the Indian premium motorcycle industry and is enjoying very strong domestic demand. Another key differentiation point for most of our holdings in emerging markets is their strong distribution network, which is crucial in these complex markets, and how they often can differentiate versus multinationals.

Attractive returns expected

Over the past five years the fund's returns have been in line with the earnings growth generated by the companies in our portfolio. This is the main reason for the fund's 21.4%¹ annual return over these five years. The fund's absolute performance in 2014 was mainly driven by ongoing strong earnings growth. After a rerating of our portfolio in 2013, we saw a slight derating during last year, which brings valuations closer to our long-term average. For 2015, we anticipate that earnings growth will continue to predominantly drive returns. The companies in our portfolio are expected to generate around 18% earnings growth per year over the next three years (based on Factset consensus data). This means that, even if the valuations of the stocks in our portfolio might continue to derate, we still expect attractive positive returns.

Important information

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¹ Gross of fees, based on net asset value, in EUR. The value of your investments may fluctuate. Results obtained in the past are no guarantee for the future.