‘Made in China’ Biotech
Cutting-edge research helps a promising industry take root
“Shoe-leather research provides unique insights that are possible only through face-to-face interactions and firsthand experience.”

There’s No Substitute for On-the-Ground Research

As any parent of a high school student can attest, there’s nothing quite like a road trip to visit prospective colleges. My wife and I recently spent a week touring nine schools with our daughter, and it was all you’d imagine. It was exhilarating to think of the knowledge she’ll gain and the experiences she’ll have. And the tidbits that parents pick up on long car rides are priceless. We knew our daughter was a devoted Beatles fan, but we were still wowed by her knowledge of lyrics and trivia.

Of course, the goal was to learn as much as possible about each college. To that end, we went on student-led tours, viewed classrooms and met professors. We tried not to embarrass our child by asking too many questions — we regularly accomplish that by simply accompanying her in public — but we managed to get in a few queries on important details.

Throughout our visits, I was struck by their similarity to the legwork that Capital Group investment analysts put in when researching companies. Beyond glossy brochures and manicured lawns, it was essential for our family to get a deep sense of each school, which could only be gleaned in person. That’s what our analysts try to accomplish when they travel to meet with company executives and others in the industries they follow. Last year, Capital Group’s 320 analysts and portfolio managers made thousands of company visits, all with a singular goal: to gain unique insights that are possible only through face-to-face interactions and firsthand experience.

In that vein, I encourage you to read the story on page 18, which provides a fascinating look at the importance of shoe-leather research and our commitment to it at Capital Group. As always, thank you for your confidence in our company. On behalf of all of us at Capital Group Private Client Services, it’s a privilege to serve you.

John Armour
President, Capital Group
THEIR BEST YEARS
Caregiving let him rediscover his marriage and reinvent himself.

INVESTMENT COMMENTARY
Enthusiasm over potential rate cuts sends stock prices up and bond yields down.

Q&A WITH BILL HURT
A veteran equity manager shares a perspective informed by decades of experience.

CHINA BIOTECH
The need to care for an aging population prompts a commitment to research.

SEMICONDUCTORS
In a deeply wired world, the demand for silicon chips remains strong.

CONSUMER STAPLES
The lure of premium products adds zest to a steady and reliable sector.

GLOBAL OPPORTUNITIES
U.S. markets have topped their foreign counterparts, but indices don’t tell the full story.

ON-THE-GROUND RESEARCH
Capital Group analysts pound the pavement to find appealing investments.

BEING BETTER
It’s possible to change your personality at any point in life.

NOTES FROM THE FIELD
Insights and observations from Capital Group analysts around the world.
Above, the ancient city of Chongqing boasts a modern skyline.
CHINA’S GROWING PAINS

Trade tensions and decelerating growth squeeze the near-term outlook
The financial markets are often a study in contrasts. It isn’t unusual for industries, sectors and even entire markets to send conflicting signals. Normally, though, the dissonance isn’t as stark as it is now between stocks and bonds. Equities have blazed to new heights as expectations of a Federal Reserve interest rate cut spark visions of an economic expansion heading into extra innings.

The storyline has been markedly different in fixed income, with sagging bond yields hinting at a more brittle economy. Indeed, flavorless global growth and the melodrama over U.S.-China trade relations are casting lengthy shadows. Still, the glass-half-full narrative has held sway so far this year, with the Fed seemingly intent on extending the U.S. economic glide path.

In the U.S., a solid second quarter helped the S&P 500 notch its best start to a year in more than two decades. Equities were propelled early on by the pause in the Fed’s three-year-old rate hike campaign, and recently by the central bank’s strong indication that lower rates are coming. Financial markets now project that the Fed will slash rates four times by the end of 2020 as it seeks to push up an inflation rate that has consistently fallen below its desired level.

The Fed’s about-face has fundamentally altered the outlook for financial markets and the global economy. At a minimum, it seems to have pushed back the potential onset of a recession in what is now a record-long U.S. upturn. The domestic economy didn’t necessarily need an immediate rate cut given that unemployment is at a half-century low and wages are on the rise. But lower rates could help to inoculate the economy against ill winds, particularly those emanating from overseas.

Falling bond yields enhanced returns but underscored risks.

The various hazards have been uppermost in the minds of fixed income investors. The bond market rallied powerfully as falling interest rates boosted fixed income portfolios. However, the plunge in bond yields was abrupt, with the 10-year Treasury yield skidding to 2.01% from 2.69% in December.

Like most other major economies, the U.S. is in the late stages of its economic cycle, with all the attendant challenges. Despite the sunny outlook for U.S. consumers, for example, manufacturing and export activity have softened. Rising labor costs threaten to eat into profit margins. And companies that have piled on heavy debt to fund dividends and share buybacks may need to unwind their leverage if the economy falters, pressuring stock valuations and triggering debt write-offs.
The U.S. outlook is also colored by the picture overseas, where China and Europe are grappling with creaky growth. Within Europe, German manufacturing activity has been weak and exports have tumbled, partly because of China’s economic travails. Like the Fed, the European Central Bank has shifted its policy stance and is now mulling the possibility of additional rate cuts and renewed bond purchases.

The big wild card is China, where the soap opera over trade with the U.S. threatens to aggravate the Asian nation’s underlying slowdown. Despite moves to boost activity, Chinese industrial production growth slumped to a 17-year low, and the economy may throttle back further in the second half of the year. Investors took comfort in the resumption of trade negotiations announced at the G20 summit. But the truce did nothing to ease the underlying disagreements, and uncertainty over trade is likely to linger. One of our Hong Kong-based economists explores the outlook for China on page 16. It’s one of several articles in this issue that examine global markets and industries. On page 18, we explain how Capital Group analysts seek to identify promising opportunities around the world.

**The outlook for key industries is encouraging.**

Our portfolio managers have gravitated toward industries where customer demand and long-term growth prospects remain strong. Cable companies, for example, are benefiting from high-speed internet connections. Despite so-called cable cutting, in which customers drop cable TV offerings in favor of streaming services, residential internet subscriptions are growing briskly.

Similarly, the proliferation of internet-connected devices ranging from smartphones to automobiles is pacing semiconductor-related companies, including designers, chip manufacturers and equipment makers. The industry is inherently cyclical and highly exposed to China, but the range of consumer products that rely on semiconductors, coupled with the eventual segue to 5G cellular connectivity, bodes well for companies with technological superiority and unique products.

Managers also have been drawn to select medical technology companies, which are benefiting from trends such as the aging of the global population and heightened attention to disease prevention. The opportunities are appealing among innovative companies in certain fast-growing areas, including heart valves and diabetes care.

**Bond yields declined around the world.**

Shaky economic conditions dragged down bond yields in major economies, including the U.K., Germany and Japan. Given the economic unpredictability and heavy leverage among some companies and governments, our fixed income team has proceeded cautiously and sought to avoid undue credit risks. As a result, managers have reduced credit risk on the margins to guard against market disruptions.

Among municipal securities, our managers continue to favor revenue bonds, which finance construction of public infrastructure projects such as water and sewer lines. As for taxable portfolios, our team is drawn to asset-backed securities in areas such as auto loans and credit cards.

In an environment of extremely low interest rates, there can be a temptation to seek to boost yield. However, that involves additional risks that can often backfire if market conditions become unfavorable. Instead, fixed income should be seen as providing diversification from equities, generating income and preserving capital. Those are always important benefits, but they take on added significance in a world of economic uncertainty.
After a long and distinguished career as a global equity portfolio manager, Bill Hurt is retiring this summer from Capital Group. In addition to overseeing investments, Bill has been a mentor to many research analysts and portfolio managers. In this interview, he offers his perspective on key economic and market issues, as well as the strategies he followed in identifying promising investments.
Given your many years of experience, how do you view today’s global landscape?

I think the world has never been in better shape, and the U.S. in particular has never been in better shape. That might seem to be at odds with some of the current headlines and challenges we face. But the world has shown throughout my lifetime that it is complex and adaptive. It is continually undergoing self-correcting transformations. To put it another way, daily existence is improving around the globe. We’ve never been better off than we are right now and never had so many opportunities. To offer just one example, smartphones have made it possible for the poorest person in India to take an online course at the best American university. Not long ago, that would have been unimaginable.

What are some of the strategies you’ve developed and lessons you’ve tried to impart to analysts over the years?

Always think outside the box. Step back and look at what’s happening in a big-picture sense. The natural instinct is to think narrowly, often too narrowly. I’ve always tried to focus on innovation and on what may be around the corner. By definition, the future is not plainly evident. You have to make a concerted effort to be on the lookout for it.

Along those lines, it’s also important to think about what can go right, in society and the world as well as with companies. It’s in our nature to focus on what could go wrong. Of course, you always want to be aware of the risks and potential downside in anything. But pessimism – focusing too much on what could go wrong – can crowd out an awareness of what could go right. And what goes right is where the future values are. I’m actually not an optimist by nature; I’m inherently a negative thinker. But I have structured the way I approach investing to force myself to look at what could go right.

Much has gone right in recent years for leading companies, especially in the technology sector. But there are concerns about high valuations in the equity market. What are your thoughts?

There’s no doubt that many of these companies are very richly valued by historical standards. But are they overvalued given their potential? I wonder whether people are spending too much time worrying when, in fact, these valuations may be justified given their prospects. These are companies that I believe are the most in tune with tomorrow, with the future. And unlike the dot-com bubble of 2000, these companies have strong underlying earnings.

Please discuss your approach to analyzing companies and selecting investments.

My objective has always been to identify good companies and to partner with them. When you buy the stock of a company, you’re effectively becoming its partner. I want to partner with creative enterprises that are going to create genuine wealth.

I try to determine whether a company can create that wealth and, more important, whether management is willing to share that wealth with shareholders. Is management focused on taking the right long-term steps to grow earnings for the benefit of all shareholders rather than simply maximizing short-term returns for the enrichment of the executives themselves? Whenever I meet a CEO, I try to determine if he or she is trying to make me a partner or simply pitch me a stock. In many ways, it all comes down to the quality and intent of management.

How do you assess that?

I look at how realistic the person is about what can be done and can’t be done, and how creative the person is in thinking about tomorrow. Those are all qualitative sorts of things. I ask open-ended questions to see what people choose to say. It’s a bit of an art form. I look as much for what they don’t say as what they do. My definition of a good interview is 90/10, in which he or she spends 90% of the time talking.

When I meet someone, my first question is “Before we start, can you talk about yourself?” You can tell a lot from how they react. You can tell if they’re thinking, “Oh boy, how do I work that into the pitch I want to give?” With other people, however, their sincerity shines through. They’ll say: “Well, I’ve done this job and that job. Now I’m working with this company, and I have all these employees who are counting on me, and we have to solve this problem and that problem.” You know that person is real and genuine. That’s who I want to partner with.
THE BIOTECH INDUSTRY IS COMING OF AGE IN CHINA

BY LAURA NELSON CARNEY

The world’s most populous country focuses on medical research as it seeks to care for an older citizenry.
When it comes to medical research, the United States and Europe are the global standard-bearers, with leading clinicians, bustling private companies and innovative cultures. But while the Western world’s pre-eminence seems assured far into the future, a promising biopharmaceutical industry is taking root in China.

Several factors are driving this, especially an urgency to improve medical care for an aging population. Far from its image as a wellspring of youth, China is getting older. And though age brings wisdom, it also brings an inevitable rise in physical ailments, which is forcing the government into action.

Chinese leaders are pursuing a dual-track approach. First, they’re seeking to cultivate a homegrown biotech industry with domestic startups producing clinically innovative and globally competitive medications. Regulators have sped up approval times for cutting-edge therapies, extended patent protections, attacked corruption and dramatically expanded government spending. The effort is yielding results as foreign researchers with impressive pedigrees – and venture capital firms with deep pockets – flock to China. The “brain drain” of the past has been supplanted by a “brain gain,” with prominent scientists moving to the country, bringing extensive experience at overseas companies and universities.

Equally notable, the government is making it easier for foreign drugmakers to tap China’s vast market. Despite their push to bolster domestic businesses, Chinese leaders want to get the most effective medications into the hands of citizens regardless of where in the world they come from. That has prompted regulators, for example, to loosen rules forcing foreign manufacturers to repeat lengthy clinical trials that they have already conducted in their home markets.

From an investment point of view, I believe the prospects are bright for both Chinese startups and overseas multinationals. China is already the second-largest pharmaceutical market in the world and could overtake the U.S. in fewer than 20 years.
An impressive biotech ecosystem is emerging in China, with an innovative spirit and vast potential that are analogous to the dawn of the U.S. biotech industry in the 1980s.

**China is opening its wallet for health care.**

The trends in China reflect some of the broad dynamics unfolding around the globe, as the mapping of the human genome and other medical milestones open doors to a new generation of clinical advances. At the same time, cost pressures are forcing companies to prioritize research because insurers and governments are reluctant to pay for ineffective or copycat treatments.

China stands out partly because it is markedly boosting spending, in contrast to other major countries, which are reinining in health care expenditures. Outlays rose at a 13% compounded annual rate in the past several years and are expected to expand 10% annually in the immediate future. As a share of GDP, spending is likely to top 7% next year, up from 4.5% two decades ago. However, that's still far below the nearly 18% level in the U.S., suggesting spending will rise further.

Demographics explain much of the shift. The median age in China, which was only 19 in 1970, will reach 38 next year and 47 by 2040, according to United Nations projections. Beyond the medical imperative, the Chinese government believes health care is capable of driving economic growth. The country is trying to reduce its outsized reliance on infrastructure and heavy industry, and leaders see medicine as having significant global demand.

**China’s biotech industry is promising but unproven.**

None of this is to say there aren’t challenges. Drug development is innately uncertain, with some treatments destined to fall short of expectations. China’s biotech industry itself is embryonic, lacking the established practices and creative history that are common in the West. For the most part, I don’t expect U.S.-China trade tensions to have a significant impact. However, the U.S. has stepped up its oversight of foreign investors on national security grounds, and the combination of heightened scrutiny and tighter export controls is creating obstacles for genomics-focused companies.

There are also questions about who will bear the costs of better medical care in China. Private health insurance is spotty at best. Chinese officials have pushed the development of private insurance for more than a decade. But progress has been frustratingly slow, with insurers covering only about 5% of expenditures. Increasingly, the government is footing the bill for cancer therapies and other innovative drugs produced by both local and foreign companies. Even so, patients still shoulder about one-third of health care bills.

Nevertheless, the overall picture is very encouraging. The government’s determination to improve care and its unprecedented push for innovation in its nascent health care market represent an important turning point. That’s clear from the huge sums of money pouring in. Last year, early-stage biotech companies in China drew about $17 billion, more than twice the $8 billion that went to U.S. competitors. As China’s middle class expands, consumers will want top-flight medical care and will have the wherewithal to pay for it. I believe there are a growing number of innovative companies with scientifically minded founders, deep benches of proven talent, vibrant research and the ability to develop globally competitive medications.

“China is already the second-largest pharmaceutical market in the world and could overtake the U.S. in fewer than 20 years.”

LAURA NELSON CARNEY

Laura is a Capital Group equity analyst covering the pharmaceutical and biotechnology industries in Europe and Asia. She has five years of investment experience and has been with Capital Group since 2018. Laura previously spent 15 years in biotech-related work, including as a research and development scientist.
Some products travel well. Semiconductors, once shackled to desktop computers, now are never far from our side. They’re in our smartphones and our cars. At work, chips are the lifeblood of laptops, copiers and even some coffee machines. At home, they provide essential bridges in our personal lives, connecting us to retailers, to entertainment and, vitally, to each other.

Put another way, chips have become our constant companions, and society’s reliance on them is likely to keep expanding as the definition of what qualifies as technology continues to broaden. With processors growing in power and sophistication, they’re increasingly threaded into industries such as health care, manufacturing, robotic equipment and artificial intelligence.

To be sure, the industry faces hurdles in the near term, including its inherent cyclical nature. Ravenous demand from tech giants such as Amazon and Google cooled last year, with the slowing global economy and maturing smartphone market triggering a bout of share-price volatility. After a strong rebound early this year, chip stocks were hit once again, this time by heightened trade friction between the U.S. and China.

Nevertheless, semiconductors lie at the heart of technological innovation and my long-term outlook remains highly optimistic. I expect moderate growth — somewhere in the mid-single digits — to resume in coming years. Beyond that, the prospects are especially promising for individual companies with clear technological expertise and differentiated products. Below are some of the reasons the semiconductor industry remains attractive.

The “internet of things” is a thing.

Though demand from smartphone makers such as Apple and Samsung appears to be decelerating, other types of manufacturers continue to ramp up the technological prowess of their products. For instance, the average new car features more than 30 computer chips, while luxury vehicles often have more than 100. Among medical devices, adoption has been slowed by regulatory barriers, but the potential is substantial, particularly in robotic surgery.

Internet-connected consumer products are also becoming ubiquitous. Android and iPhone handsets can now control everything from home security systems to backyard sprinklers. Refrigerators can automatically order food via online delivery services. These products all require smaller and more specialized chips.

The move to 5G, or fifth generation, cellular connectivity is also underway. It may feel like an evolutionary shift at the moment but, in my view, it will lead to revolutionary advances. The limits of 4G will be largely eliminated, especially high latency due to lower speeds, and devices will be able to communicate with one another almost instantaneously.

Once 5G becomes widely available in the next few years, it will create new business models and boost the current tech giants as internet search, social media...
and e-commerce become more ingrained in daily life. Artificial intelligence applications and virtual reality devices, both of which require advanced chips, are likely to proliferate.

The semiconductor industry – which includes designers, chip manufacturers and equipment makers – is experiencing the same consolidation pressure as other sectors, and mergers are reshaping the landscape. In 2003, for example, there were 25 manufacturers of logic chips. Today, the business is dominated by three companies: Intel, Samsung and Taiwan Semiconductor. In specialized areas, there often is only one supplier, such as Dutch chip-equipment maker ASML, whose extreme ultraviolet lithography machines produce the most advanced chips in the world and cost upward of $100 million.

Consolidation is a sign that the business is maturing and that the days of supercharged growth are giving way to moderate and even slow growth. However, the industry’s financial impact continues to loom large. In 2018, chip companies generated record sales of $468.8 billion, up 13.7% from the previous year, according to the Semiconductor Industry Association.

The industry can withstand trade friction with China.

There’s no doubt that trade wrangling between the U.S. and China is casting a shadow over chip companies. Deals have appeared within reach and then dissolved amid ramped-up U.S. tariffs and sharpened rhetoric. The fracas has created significant question marks – for example, what will become of Huawei, a massive Chinese cellphone and cellular communications manufacturer that has been effectively shut out of the U.S. market.

Still, it’s important to point out that last year’s record sales came despite the second-half slowdown and the rough-and-tumble of the trade dispute. In fact, trade relations might not affect the industry’s drivers: China relies on outside manufacturers for cutting-edge semiconductors because its native industry lags by years, if not decades. That gives the country’s leaders a strong incentive to make some kind of trade deal.

Overall, semiconductors continue to power the technology-based resurgence that has characterized the post-financial-crisis period. I see strong tailwinds for this industry, particularly with the advent of 5G and the ever-growing roster of connected devices. Both developments should bode well for investors with the patience to take a long-term view.

ISAAC SUDIT
Isaac is a Capital Group equity analyst covering the semiconductor industry in the U.S. and Europe, as well as semiconductor equipment companies globally. He has 20 years of investment experience and has been with Capital Group since 2005.
In some ways, the consumer staples sector is the minivan of the equity world — steady, reliable and decidedly unglamorous. But as with the multipurpose family vehicle, it can be all too easy to overlook the sector’s many appealing attributes.

Consumer staples companies churn out everyday necessities that people buy regardless of economic conditions, such as food and household products. These businesses tend to have solid earnings and dividend-paying cultures. And the sector has historically been defensive, providing comparative refuge during periods of stock market turmoil. These traits are always attractive, and perhaps never more so than at an advanced stage of the economic cycle.

Beyond these features, consumer staples companies are at the forefront of several global trends, including the ongoing rise in emerging market living standards and the burgeoning preference for upscale products among consumers around the world. Though these items are higher priced, buyers view them as affordable luxuries that are high in quality and confer a certain cachet. Premiumization, as it’s known, is an important current flowing through industries, such as cosmetics, liquor and food.

Of course, the prospects for some companies are much brighter than for others, and the ability to identify the most promising businesses is critically important. Some segments of the sector are grappling with limited pricing power and lukewarm organic growth. And in a world where online arbiters wield sizable cultural influence, businesses of all stripes must contend with rapid swings in consumer tastes.

Nevertheless, companies with global franchises and prominent brands have distinct advantages, according to Capital Group Private Client Services analysts. These companies tend to have pricing power, high margins and the marketing muscle needed to maintain customer awareness in an oversaturated retail ecosystem. Consumer staples businesses don’t boast the explosive profit growth of some other sectors, but the durability of their earnings can persist through fluctuations in economic and market cycles.

“Most companies have good exposure to the growth potential of emerging markets,” says analyst Saurav Jain, who follows European food producers and household personal products. “And because their earnings are resilient and balance sheets are strong, these companies tend to fare better in downturns than other industries.”

Chinese consumers are going upscale.

Despite China’s sluggish economy and the current trade clash with the U.S., the Asian giant is expected to remain a powerful source of growth. Though economic uncertainty could dent consumer confidence in the near term, the appetite for premium products among China’s expanding middle class is likely to keep accelerating. Practical
Premiumization is a global phenomenon. Consumers want upmarket liquors, the most absorbent diapers, the most nutritious baby formula. Considerations and the aspirational nature of the products are driving a secular shift to higher-level offerings.

This is evident in the cosmetics industry, where China is generating more than 50% of growth for global companies. Chinese consumers differ in key ways from their U.S. counterparts, says cosmetics analyst Joyce Ye. There is a greater cultural emphasis on skin care, customers begin to use premium products at younger ages and shoppers are willing to pay for aspirational brands.

“People care about their skin and their overall health, and they see these products as important,” Ye says. “Demand is structural rather than a passing fad.”

The appeal of higher-quality offerings extends to other industries. Parents, for example, want the most absorbent diapers and the most nutritious baby formula for their children. Chinese homeowners, meanwhile, yearn for appliances that make their lives easier, such as dishwashers and clothes dryers. With fewer than 2% of urban households owning a dishwasher, sales ballooned 88% in China last year and are expected to surge an additional 40% this year.

Beyond emerging markets, premiumization is a global phenomenon. For example, consumers throughout the developed world are turning to upmarket liquors. “Instead of having three or four drinks when they go out for dinner, people will have one or two,” notes beverage analyst Archana Basi. “They’re willing to pay more for them because the taste is better.”

Visionary management is a key differentiator.

Savvy management is essential given the challenges posed by shifting consumer tastes and other forces. The food industry, for example, tends to be among the most defensive in the staples sector. But it is being buffeted by consumers’ affection for organic and plant-based offerings. Some businesses are better positioned for this trend than others.

Overall, the outlook is promising for companies with enduring brands and management teams that are adept at spotting trends around the globe.

“Strong managers can galvanize growth by targeting the right categories, making prudent acquisitions and disposing of weak product lines,” Jain says. “A good CEO can have a transformational effect on a consumer staples company.”

**China Beauty Market**

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<th>Year</th>
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Source: General Administration of Customs of China. Actual and estimated.

**Baby Food**

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<td>2021</td>
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Source: Statista. Actual and estimated. +7% reflects compound annual growth rates. As of March 31, 2019.

**Diapers**

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<td>2021</td>
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Source: Statista. Actual and estimated. +4% reflects compound annual growth rates. As of March 31, 2019.
A World of Opportunity

The middle class is expanding rapidly in China. Innovative companies are sprouting throughout the emerging markets. And breakthroughs in technology, medicine and communication are transforming the complexion of the global economy.

The world, in short, is undergoing exciting, if occasionally nerve-jangling, change.

In the following pages, we explore the opportunities arising throughout the world, as well as the formidable challenges presented by heightened trade tensions and China’s economic growing pains. We also take a look at the on-the-ground spadework that Capital Group analysts do as they venture out in search of promising investments around the globe.
Other than the Federal Reserve’s upcoming decision on interest rates, many of the biggest questions in the world these days center on China. The off-again, on-again trade talks with the U.S., and the ongoing queasiness in the Chinese economy, have clouded the outlook for global growth. The abrupt collapse of trade negotiations in May drove home the magnitude of the conflict between the two countries. And though they’ve agreed to resume discussions, the overall uncertainty has jostled a Chinese economy that was already wrestling with structural challenges such as heavy government debt and industrial overcapacity.

The long-term outlook for China and the opportunities for investors remain encouraging. Even with the trade stalemate, the Chinese economy is still growing – not a small feat given the whirlwind of financial and political crosscurrents. The housing market has generally held up and the spending power of millions of consumers continues to advance. Wage growth among urban professionals, for example, is climbing at a high-single-digit to low-double-digit clip. As incomes rise, Chinese consumers are showing an ever-greater affinity for the comforts of middle-class existence, including premium goods and global travel, as well as improved health care and similar quality-of-life concerns. These dynamics should benefit both foreign-based multinationals and a crop of domestic Chinese companies.

The near-term picture, however, is muddied. I expect the economy may disappoint in the second half of the year amid weak credit growth and sputtering manufacturing activity. The government has deployed an assortment of stimulus measures, including income tax cuts, small-business lending and infrastructure spending. Chinese leaders have yet to significantly loosen monetary policy as they try to thread the needle between sparking the economy and tackling longer-term reforms. Nevertheless, the government likely will push whatever levers it can if growth projections deteriorate.

The timing of a trade deal is uncertain.

Despite a general consensus that the U.S. and China will ink a trade agreement this year in the lead-up to the 2020 U.S. elections, it’s not clear that will happen. Neither side wants to be seen as caving in to external pressure, and the back-and-forth volley of accusations that have characterized the negotiations to this point may indicate a hardening of positions.

The tariffs that the U.S. has imposed on Chinese products are likely to have a tangible but ultimately modest impact, skimming roughly 0.5% from GDP. (The Chinese government pegs the country’s economic growth at better than 6% annually, although I believe it’s closer to 4% to 5%.) The potential hit to business confidence, however, could mean a notably sharper slowdown than economic models suggest, as companies may hold off on capital spending until the path is clear. I met recently with a Chinese restaurant company that may moderate a planned expansion out of fear that consumer spending will fall. This was a domestic company with no exposure to global trade — indicating the general caution that could take hold if the trade fracas drags on.

A big question concerns the U.S. threat to slap 25% tariffs on the roughly $300 billion in Chinese goods that thus far have been spared in the trade showdown. These consist largely of consumer goods such as smartphones, laptops and clothing; higher prices for these items would be borne largely by American shoppers. The U.S. agreed to hold off on these levies as part of the latest round of negotiations, and I doubt these tariffs will come about because of the harm they could do to the U.S. economy. At this moment, it seems likely that the trade clash will ding China but not push it into recession.

Stock selection is more important than ever.

Despite the near-term headwinds, it’s possible to uncover promising investment opportunities through fundamental...
WHERE ARE THE BEST STOCKS IN THE WORLD? ALL AROUND THE WORLD.

It’s been a tough few years for international markets, as a decade of dominance by U.S. stocks has raised questions about the wisdom of investing outside the 50 American states.

But while international markets have generally lagged the U.S., the index-based returns that sway public perceptions tell only a partial story. In fact, the picture is dramatically different on a company-by-company basis. Since 2009, the 50 companies with the best annual returns have overwhelmingly been headquartered outside the U.S. In many years, 80% to 90% were based elsewhere.

This is due partially to industries congregating in specific countries or regions, and to the subsequent composition of indices. International markets generally have a greater concentration of value-oriented stocks in “old economy” sectors such as financials and basic materials. Consumer staples stocks are also large components of European indices. Contrast that with the slew of technology and consumer tech giants based in the U.S. Their heaping presence in the S&P 500 has electrified that index, accounting for much of the return gap with other markets.

But the U.S. doesn’t have a hammerlock on attractive industries. For example, a constellation of August luxury goods houses are based in Europe. They include Louis Vuitton and Fendi, which are owned by LVMH, and Gucci, owned by Kering. Likewise, many of the world’s leading pharmaceutical companies are headquartered in Europe; AstraZeneca, Novartis and Novo Nordisk are on that list. Japan, meanwhile, is home to cutting-edge robotics firms such as Murata and Fanuc.

Vuitton and Fendi, which are owned by LVMH, and Gucci, owned by Kering. Likewise, many of the world’s leading pharmaceutical companies are headquartered in Europe; AstraZeneca, Novartis and Novo Nordisk are on that list. The upshot is that the location of a company’s headquarters is of minimal importance in a globalized economy where multinationals frequently generate extensive revenue outside their home countries.

Beyond their diversification benefit, overseas stocks have attractive traits including higher dividend yields, the chance to gain from currency tailwinds if the strong U.S. dollar weakens and – perhaps most compelling – substantially lower valuations.
When Capital Group equity analyst Lara Pellini set out to research the online food delivery industry, she wanted to learn all she could. She spent hours studying the companies that were catching on around the world. She pored over financial statements. And she ordered lots of delivery meals.

Then Pellini hopped on a bicycle.

Pellini wasn’t seeking exercise or a momentary diversion. Instead, she wanted to round out her analysis with firsthand experience. These businesses promised to pick up and quickly deliver meals that customers ordered from nearby restaurants via smartphones. How long, Pellini wanted to know, did deliveries actually take? What problems cropped up? Did delivery people enjoy their jobs, and were they likely to stick with them?

“This industry is very attractive because the potential is really huge,” Pellini says. “But these companies are fairly young, and it’s critical to understand the nuts and bolts of how they really work. You cannot get that by sitting at your desk.”
So with the permission of one service, Pellini signed up to make deliveries. Equipped with a company-issued bike and an insulated food pouch, she peddled around central London. She got an up-close look at the burgeoning demand for online food delivery services, especially among office workers ordering dinner at their desks.

“I had no idea so many people were eating in the office and ordering food like that,” she says. “This might one day replace workplace cafeterias and food services.”

Pellini also got a taste of the logistical challenges, such as restaurants not having food ready when she arrived to pick it up. Overall, she came away from the experience with a sharpened sense of the industry and its prospects – and her London outing was only the beginning. To gauge the differences among individual companies and the markets in which they operate, Pellini delivered food for a company in Glasgow. She plans similar trips to France and Spain, and is collaborating with colleagues who are doing the same in other parts of the world.

There’s no substitute for old-fashioned shoe leather.

Not every analyst dons a windbreaker and a bike helmet, but on-the-ground work is a central component of Capital Group research. Dissecting financial statements and regulatory filings is essential, but often just one step in assessing the merits of a company or industry. Analysts regularly meet with corporate management teams and others, including customers, suppliers, distributors, competitors and former executives. Though meetings often happen in one of the cities around the world in which analysts are based, Capital Group researchers and portfolio managers often travel elsewhere, such as to trade shows and industry conferences. They also regularly visit companies for one-on-one discussions with CEOs and other executives.

Capital Group commits substantial resources to global research. Last year, Capital Group’s 320 analysts and portfolio managers traveled to 42 countries, from Switzerland and South Korea to Slovenia and South Africa. In an information-soaked world awash in data, their goal is to unearth nuggets that can be gleaned only from touring factories, walking through research labs and peppering outsiders with questions.

“The depth of primary research is one of the key advantages that we have as investment analysts at Capital Group,” says Jason Karam, a New York-based analyst who tracks Latin American companies for Capital Group Private Client Services. “The goal is to build a mosaic, and developing a network with many sources of knowledge is invaluable. That can only be done by going to the source and traveling to these markets.”

Company visits provide important access to midlevel managers who don’t make the rounds at investment conferences but have keen insight into businesses and industries.
Analyst Lara Pellini hands off food deliveries in Glasgow, Scotland. She also biked meals to buyers in London.

Top, analyst Archana Basi (right) and Portfolio Manager Cheryl Frank (center) visit a distillery. Below, they tour a Kentucky barrel-making plant.

Top, analyst Jason Karam visits the floor of a Brazilian cookie manufacturer. Middle, the treats roll off the line. Bottom, Karam grips the railing of a boat as it speeds through a Brazilian harbor.
“Sometimes the most valuable meetings you have are with division heads or executives who are not in the public eye all the time,” says Greg Fuss, an equity portfolio manager at Capital Group Private Client Services. “You can really dig down into the weeds with people who are excited to be asked about what they do.”

One such discussion occurred at a retailer that sells food and other items. After meeting with the CEO, Fuss spoke to the head of the meat department, who offered a detailed explanation of the food-prep process.

“It was very impressive,” Fuss recalls. “A consumer might not necessarily notice all the effort that goes into trimming the fat or preparing the cut. But they’ll appreciate it when they go home and prepare a meal, and they’ll come back to that store.”

The commitment to research helps analysts build credibility with companies and develop rapport with executives. “It’s very helpful to have a decadelong relationship with the new CEO before he or she assumes the role,” Karam observes.

In the course of their travels, analysts visit a range of venues. Archana Basi, a London-based analyst who follows the spirits industry for Capital Group Private Client Services, has gone to distilleries in Kentucky and watched in fascination as iconic wooden whiskey barrels were assembled. She’s also broiled in sun-baked fields as agriculture workers surveyed crops in Mexico and navigated a jam-packed beer convention in San Diego.

“I talked to a whole bunch of distributors who are literally moving the product and dealing with the stores,” she says of the beer convention. “I just had casual conversations to get a sense from them as to which products are really working.”

Occasionally, a research trip goes in an unexpected direction. Karam thought he was in for a gentle cruise when a South American port operator offered a harbor tour. Instead, Karam, who was clad in a suit and dress shoes, clutched the railing with both hands as the boat sped through the water. “I literally almost went over the edge,” he recalls. Karam had a better experience at a commercial bakery in a remote city in Brazil, where he savored warm cookies rolling off a conveyor belt.

**It’s important to understand the good and the bad.**

While research trips often spotlight promising investments, they sometimes turn up red flags.

A few years ago, a European supermarket let Pellini stock shelves. The company had generated considerable buzz with a marketing campaign touting low prices. Pellini found the opposite when she walked the aisles of a competing chain on her lunch break and bumped into employees of the first store shopping at the second.

“They looked at me and said, ‘Please don’t tell our company you saw us here,’” she remembers. “I said, ‘Don’t worry, but please tell me why you’re here.’ It turns out they were getting every kind of employee discount and yet they shopped at the competitor because it was much cheaper.”

Not surprisingly, research tends to become a way of life for analysts, even in their spare time.

Basi reflexively checks out marketing displays and product placement in liquor stores. At restaurants, she peppers bartenders and even patrons with questions. “I’ll ask the bartender, ‘Hey, what’s really moving? What’s the product that people like to drink?’”

For Pellini, checking out delivery services became a family affair, with her 8-year-old son querying anyone who rang the doorbell.

“My son knows that every time we order food delivery I interview the driver,” Pellini says. “Now he asks people if they prefer working for one service or another. He says, ‘Do you mind if I ask how many drops you have done in the last hour?’”

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“Last year, Capital Group’s 320 analysts and portfolio managers traveled to 42 countries, from Switzerland and South Korea to Slovenia and South Africa.”
In recent years, researchers have discovered that our personalities aren’t set in stone. Does that mean we can choose to be better versions of ourselves?

The conventional wisdom on personality used to be simple: After age 30, your personality was set forever. Anxious? Angry? Afraid? Well, the thinking went, if you didn’t grow out of an unwanted trait early in life, you just had to accept it and age gracefully. But psychologists and researchers have spent the past several years dismantling that view, and many now say that personality change occurs throughout our lives.

Part of this is due to a natural evolution that plays out unconsciously as we gain wisdom and maturity. Our life experiences, and how we react to them, shape our personalities in ways that are imperceptible in the moment but significant when compounded over time.

“You might recognize the topography of your friend’s personality at the 50-year reunion, but the details might have changed a decent amount,” observes Dr. Brent Roberts, a professor of psychology at the University of Illinois.

Beyond that, an emerging body of research indicates that people can intentionally modify their personalities through steady effort. A lifelong wallflower may not magically bloom into the life of the party, but mutability of personality and how much agency a person has to make such adjustments appear to be much greater than once thought. Equally notable, the new research suggests that people can implement meaningful changes at any age. In fact, not only is age not a barrier, it may in some ways be an advantage. The ability to pinpoint a goal and pursue it with clarity and purpose generally improves as we get older.

Broadly speaking, psychologists classify personality traits into five basic categories — openness to new experiences, conscientiousness, extroversion, agreeableness and neuroticism — and subdivide them from there. For example, someone with high conscientiousness — “a long way of saying ‘grit,’” Roberts says — is likely to be focused, driven and organized. Someone with low conscientiousness tends to be easygoing, carefree and messy. Tests for these traits have long been used by researchers to take snapshots of an individual’s personality to compare over time.

Roberts’ research found that life changes are linked to changes in these five categories. One study showed that emotional stability, conscientiousness, assertiveness and agreeableness tend to improve with age. Another found that students who take vocational training tend to be more conscientious than peers who attend academic schools.

So if experience and choices can alter personalities, the bigger question is: Can people intentionally mold their personalities through dint of effort? In other words, can we choose who we are? Research by Dr. Nathan Hudson, an assistant professor at Southern Methodist University, suggests we can.

“Modern personality theories suggest that one way to change personality traits is to simply change thoughts, feelings and behaviors over an extended period of time,” he says. “For example, if an individual wants to become more extroverted, they may be able to accomplish this goal simply by behaving in an extroverted fashion for extended periods of time.”

It seems tautological — to be more outgoing, just be more outgoing — but Hudson’s research shows that regularly planning and achieving small, reasonable goals is linked to changes in personality tests.

He explains: “For example, someone who wants to be more conscientious might make goals each week similar to ‘pay the bills as soon as I receive them,’ ‘clean up a small mess in my home’ or ‘show up 10 minutes early for my appointment on Tuesday.’” Hudson’s studies found that, after four months, people who followed such exercises showed significant, measurable improvements in the trait they were focused on.

In her book, The Achiever Fever Cure, author Claire Booth explains how she reduced the worry and anxiety stemming from...
from her fixation on building her market insights firm. Although Booth’s career was surging, fear and self-doubt kept her up at night. She resolved to change when an employee wrote in a management review, “I know what kind of day it’s going to be as soon as Claire walks in the front door.”

“That was my wake-up call,” Booth says. “I wasn’t hiding this anxiety and insomnia. In that moment, I finally realized that, if I don’t change, I’m going to become a liability to my own company.”

The keys to her change? Being aware of her internal critic and disarming it.

Each day, Booth journaled instances of her self-doubting internal voice and her reactions. She also sought to be aware of the physical signs of creeping anxiety. She realized that the subtle pains and tics she’d ignored – a tightened stomach, an unconscious grimace – were indicators. She began meditating daily, which helped her develop self-awareness. Soon she found she could hear her inner critic more clearly and ignore it when it wasn’t helpful.

Booth is quick to point out that there’s no fast personality fix: “One of the questions I often get asked is, ‘What’s the fastest way to get rid of it? How do I fix this? Give me five quick steps. Give me the hack.’ And, of course, like anything, that’s not how it works.”

Hudson says ambitious goals are unlikely to result in sweeping changes. “Traits change slowly over time, and taking steps to change one’s thoughts, feelings and behaviors may require substantial effort,” he says. “People who want to make unrealistically large changes may be setting themselves up for disappointment.”

What’s the payoff for all this work? There’s a strong link between certain personality traits and positive outcomes, Roberts says. Conscientiousness, for example, is a positive indicator for performance at school and work, as well as for stable and satisfying marriages and for general health. What’s more, as individuals see changes in conscientiousness, they tend to see changes in outcomes – in other words, it’s never too late.

Booth, for her part, says she’s happier since she slowed down and began her self-evaluation. She plans to step away from her company to do some traveling – a choice she says she wouldn’t have made five years ago, when she was lying awake at night convinced she hadn’t done enough to build her firm. “It’s incredibly empowering and incredibly freeing,” she says.
HOW A SPOUSE’S ILLNESS SPARKED AN EPIPHANY ABOUT LOVE

George Shannon didn’t know it, but a terrible night in Mexico would lead to what he now calls the most gratifying experience of his life. While on vacation, his wife Carol suffered a stroke from which she would never fully recover. He would eventually become her full-time caregiver – a turn of events he never sought, but which resulted in a deep sense of purpose, heightened compassion and a life-altering epiphany about true joy. Shannon’s book – The Best Seven Years of My Life, which he wrote with his son, Chad – explores his personal journey, including his shift in focus away from himself and how unexpectedly rewarding that turned out to be.

A spouse’s sudden illness is painful under any circumstances. How did you get to The Best Seven Years of My Life from there?

George: I started to care for Carol and it was unrelenting. The medical issues kept coming at us and I would spend my entire day taking care of her. I did a lot for Carol, but I would always question whether I was doing enough. Was I making her feel the love? I decided that I wasn’t doing enough. Everything that I was doing was not about Carol. It was about me. I was laying there saying, “Gee, I didn’t get to play golf today. I didn’t get to go have a drink with my buddies.”

And then I decided to make it all about her. I decided to push all that stuff aside, all that garbage, and just do everything I could do to make each day the best of her life. When that happened, my heart and soul just opened up and we connected like you couldn’t believe. She sensed it. She could tell that something was changing in me. We just connected
and had a wonderful seven years together. And I fell madly in love with her all over again. She did too.

Chad: It occurred to me, as I was writing the last chapter, that it really wasn’t my dad changing my mom, or Dad leading her to a more complete life. Rather, my mom led my dad to a more complete life. It really blew his mind to sit there and think about the fact that she was the one who was instilling change in him. He never would have imagined that.

You outline in the book some of the moments of happiness for Carol and the closeness you both experienced.

George: I never heard her swear for 40 years. Then wow. The filters were off and she would just let it go. She became absolutely hysterical. She said the darnedest things to me, which was hysterical because I was always trying to change her. I was always trying to get her to come out of that shell she was in. I couldn’t ever get her to do it. Well, the stroke did it for her. She became hilarious.

How did this experience change you?

George: I found humility. It was the key. I was doing all these things and I was trying to be perfect and I was trying to make no mistakes. I had done that in my business and in all of my relationships. And that’s probably why I was questioning myself so much. I did something, and I did it well, but I would question whether I could have done it better. That’s when I decided to stop worrying about me and make it all about her.

Chad: Accepting the circumstances was probably one of the biggest fulcrums to the chain. My dad has certain visions of the world the way it should be. Those expectations at first were that she could get better, and that created some tension when she wasn’t able to get better. But when he started to accept the circumstances, that she wasn’t going to get better, that humility kicked in because then he really accepted it all. Once he did, that’s when they started having a lot of fun.

What message do you hope readers take from your story?

George: The big message from my perspective is pretty simple. Things happen in your life that you don’t get to choose. You can’t change it. You do get to choose your response to it, so find the good.

Chad: One of the things that doesn’t necessarily come explicitly through in the book, but that I see in retrospect, is that redemption never comes too late. And it comes in all kinds of forms. So you can always redeem yourself by your actions. You can always redeem yourself with those with whom you’ve had long relationships, short relationships, whatever.

Carol Shannon passed away in 2017. George Shannon lives in Pennsylvania, where he’s on the board of the cemetery where Carol’s ashes are interred. Chad Shannon is a writer and lawyer who’s working on other biographies.
EMPLOYERS ARE SCRAMBLING TO KEEP WORKERS

The red-hot job market has already caused companies to hike wages and step up the recruitment of new employees. Now it may be sparking another dynamic: labor hoarding. Layoffs as a percentage of the U.S. workforce are notably lower than in the past, and part of the reason may be employers’ reluctance to part with workers — even marginal ones — when it’s so difficult to find replacements. Though this scenario won’t last indefinitely, it points to how tight the employment market has become. Another telling statistic: The percentage of people who are finding jobs within a month of entering the workforce is at a record high.

YOUNG CHINESE CONSUMERS FAVOR LOCAL PICK-ME-UPS

China’s millennials are thirsty for trendy brands with Chinese roots, and their latest object of affection involves a homegrown twist on the flavored-tea market. Stores featuring so-called cheese tea — drinks with fluffy dairy toppings in clever packaging — are drawing throngs of young consumers, some of whom endure lines of an hour or more. The stores feature chic interiors, online ordering and tasty drinks.
A variety of factors make it likely that the home remodeling industry will keep growing. At 43 years old, the average U.S. home is reaching an age at which repairs are commonly needed. Also, people are staying in their houses longer than in the past, partly because of the high cost of moving to bigger homes, making them more willing to undertake repairs. And homeowners can tap the equity in their current houses to fund upgrades. Remodeling activity probably won’t grow as fast as it did in 2018 due to a slower rise in home values and less storm-related damage. Still, it’s expected to grow in the low single digits for the next three to four years.

THE OUTLOOK FOR EUROPEAN BANKS IS UNINSPIRING

Political and economic challenges continue to weigh on European banks, as they have for much of the past decade. Brexit, Italian debt woes and accusations of money laundering are the latest hurdles for a sector that has struggled with low interest rates and weak loan demand. With rate hikes becoming less likely amid global economic uncertainty, few tailwinds appear forthcoming.
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