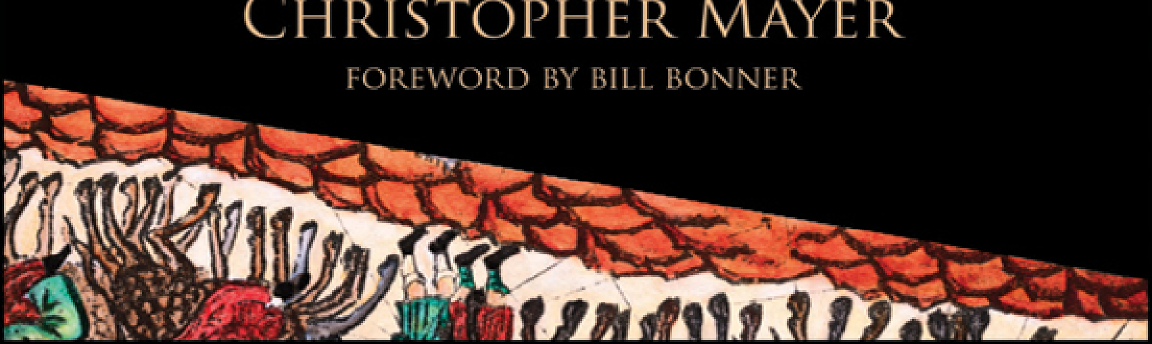
WORLD RIGHT SIDE UP

Investing Across Six Continents

Christopher Mayer

Foreword by Bill Bonner



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Foreword

Sometimes It's Different

The material progress in the developed world over the past 300 years is undeniable. But the closer you examine it, the less it appears as a tribute to how clever the human race is, and the more it seems to be an illustration of how lucky Europeans have been.

Europeans embraced the Industrial Revolution. Others did not or could not. Thus, the world turned against the non-Western countries, relatively, at the beginning of the Industrial Revolution. But if the world turns long enough, it comes back to where it began. And such is the case today.

Over the past 10 years, the real, private-sector economies of the developed world have grown at medieval rates. Meanwhile, the emerging markets have enjoyed a growth spurt. They are catching up breathtakingly fast.

When I was a student in 1969, I visited Paris. I went back to live in Paris in 1999, 30 years later. Almost nothing had changed. Same buildings. Same people. Except for the automobiles people drove and the clothes they wore, you would barely know that it had changed at all.

In the early 1980s, I went to China. I was taken to a barren track of dirt and dust and told that a new city, Shenzhen, would be built there. It was hard to believe. The whole country seemed desolate, gritty, and poor. When I returned in 2010, it was not the same country. There are believed to be three times as many people living in Shenzhen as in the whole Paris metropolitan area, and it is only one of dozens of new cities. Beijing, which used to be such a gray, empty, and lifeless place, is a city of gleaming towers, luxury automobiles, and traffic jams that can stretch for a hundred miles.

There is a lesson in all of this.

Most people see material progress as a result of continual innovation, investment, and technical achievement. We have come to see it that way because that is how it has appeared for generations. Once the enlightenment was reached, we thought continued material progress was guaranteed. The scientific method made improvements routine, examing new ideas and reexamined old ones, systematically rejecting what was unsound and adding to the accumulated knowledge of the human race. Freed from the limitations of the past, we could look forward to more wealth and knowledge, forever.

But the world doesn't work that way. No one stays on top for long. Competitors are everywhere.

For example, agriculture seems to have begun in the fertile crescent of Mesopotamia and the Valley of the Nile long before elsewhere. But the richness created by sedentary farming proved a lure for the steppe tribes, who seemed to have had an edge of their own. They had learned how to use the horse, to hunt, and to fight. Mounted warriors raided and later conquered the farmers.

Likewise, the tribes who invented the bow and arrow must have played hell with those who had not.

Technological progress did not bless all of the world's people evenly or at the same time. In the jungles of South America, Southeast Asia, and Africa, as recently as a few years ago, there were people who still lived as they had 10,000 or 20,000 years earlier.

In Europe, Asia, and America at the time of America's discovery, there were advanced civilizations of roughly similar standards of living. (I am probably being a little generous to the Americans of the fifteenth century.) Neither Inca nor Aztec civilizations could rival those of Europe or Asia. The Americans didn't even use the wheel. Still, in 1600, there was probably not much difference between the living standard of a serf in Europe, a slave in China, or a field hand in the Andes.

It is no surprise that those who took up the use of fossil fuels first and most aggressively, backed by institutions and customs that had evolved to suit the new technology, stole a march on their competitors.

Europe, and its colonies, raced ahead on coal-fired trains and oil-fired battleships until it had destroyed the civilizations of the New World and tamed those of Asia. India was host to the French and the Portuguese, before being taken over completely by the English. Japan was forced to open its doors to foreign trade and became a rapid, gifted imitator. China was besieged then battered by Western warships.

The world is different now. It's changing all the time, taking surprising twists and turns that create opportunities for venturesome investors. You'll read about many in this book.

Chris Mayer has traveled around the world looking for these opportunities. Together, we've been to China, attended conferences in France, and dined in Nicaragua. He keeps his eyes and ears open. You'll enjoy reading about, and perhaps profiting from, what he has uncovered.

—Bill Bonner

Acknowledgments

Author Albert Jay Nock (1870–1945) once said, "You don't try to repay the help that is given you. You pass it along to others." This book is an effort in that direction, because I can never repay all the help given to me in putting it together.

I want to thank Addison Wiggin, my publisher at Agora Financial, friend and long-time booster of my work. We were bouncing around in a cab in Bogotá one day when he said to me, "I think you have another book in you." The result you hold in your hands would have been impossible without his support.

A special thanks to Samantha Buker, my associate editor at Agora, who was an enormous help in organizing and editing the mass of material into a coherent form. The book is much improved because of her efforts.

Thanks to Susi Clark for the wonderful cover and for all the charts, and to the unsung efforts of Erik Kestler, our diligent copyeditor. Thanks to all my friends at Agora Financial for their support and good cheer, especially Bill Bonner, Joe Schriefer, Eric Fry, Greg Grillot, Jack Forde, Joel Bowman, Bruce Robertson, and Mark O'Dell. Thanks to Deb Englander and Kimberly Bernard at John Wiley & Sons. And to Eric Winig, for all those conversations at HQ and the ideas they inspired. And thanks to all the people I met along the way who took time out of their busy lives to show me around. I must also thank my loyal readers who make it all possible.

Finally, thanks to my family, especially my wife Carol, who put up with my sometimes hectic travel schedule and late night and weekend writing as deadlines loomed.

Travel, its very motion, ought to suggest hope. Despair is the armchair; it is indifference and glazed, incurious eyes. I think travelers are essentially optimists, or else they would never go anywhere.

—Paul Theroux, *The Tao of Travel*

Preface

Notes before We Go

I want to say a few things about what you are about to read . . .

Please remember this book is written from the perspective of an investor—a great enthusiast of all the world's charms but still an investor searching for ideas. I'm not writing a piece of social commentary or proclaiming deep knowledge about the nature of a place or its people. My aim is to find investment opportunities and trends.

In my travels, I've met a lot of new people and gained valuable contacts. But the fact of the matter is that the spadework of successful investing is mostly done from afar. In fact, many of my most successful investments came from companies I never met in places I've never been. That is as it should be.

A great investment idea should be plain, clear, and nearly obvious. I say "should" because many times they are, but there are always exceptions. The idea of investors harboring secrets and holding insider knowledge is something drummed up by people as a way to explain something they don't understand. It's propagated by many people in the business to whom such ideas are self-serving.

Most investing insights come from unglamorous trolling of publicly available data, mixed with some creative foresight and a good stomach not afraid to stand against a crowd. Conviction, patience, diligence: These are more important than secrets (or travel, for that matter).

I'm a big believer in history as a teacher. Sometimes, the best history books don't come from the desks of historians. They come from the works of inquisitive and observant scribblers at the scene, suffused with the immediacy of the moment and of what they see and hear. The insights are fresh when recorded, unspoiled by the editing of long memory looking back over many years.

You'll see I often refer to the works of travelers. On a trip to China, I picked up a used copy of *Shark's Fins and Millet*, written by Ilona Ralf Sues, a journalist who traveled to China in the late 1930s. Sues' book is a personal look at China as she traveled it: Canton (now Guangzhou), Shanghai, Nanjing, Hankou, Shanxi, and Yan'an. In her words, the book:

> . . . *is neither a study, nor a travelogue, nor a political treatise. It is a medley of everything, as unorthodox as life itself—an unconventional set of stories and anecdotes—a series of big and small events, of great and little people observed, not through a high-powered microscope, but with the imperfect, naked, sympathetic, twinkling human eye.*

I write this book in that spirit.

What does all this have to do with the stock market and investing? A good investor is a worldly investor who has an understanding and appreciation of how the world works and how it came to be. Reading old (and new) travel books has given me a glimpse of such things. It teaches me how to ask better questions of my hosts: traders, fund managers, bartenders and cabbies alike.

I've been lucky to be able to see the world. They say travel broadens the mind. Maybe it does. Or maybe they have it backward. Maybe it's the broad-minded people who travel. When I think of all the wonderful, well-traveled people I've met out there on the road, I can't help but believe that's the right way to put it. It's a memorable experience to bump into another American in a bar in a small town somewhere in southern Brazil. Odds are he's worth chatting with, a curious mind with good stories to tell about his own small discoveries.

For me, a place is always about the people I've met and, especially, those who took some time from their own busy lives to show around a curious traveler. You'll meet more than a few of them in the pages that follow.

—Chris Mayer

CHAPTER 1

The World Right Side Up

One thought always strikes me in my travels. I'll be sitting in a comfortable bistro in Medellín with its doors open to the warm night air wafting in gently from a quiet street, in a restaurant on a man-made island gazing up at the tallest tower in the world twinkling on a starless night in Dubai, at a bar in Cape Town, in a noodle shop in Beijing, or countless other places around this ever-fascinating planet of ours. And the thought will hit me.

If I close my eyes, I could easily imagine myself in New York, Washington, D.C., or any number of American cities. Of course, each of these places is different from each other in many ways, and yet they are much the same.

People are people around the world. They like many of the same things. They want to have a better life. They want to have a safe home, wear clothes they like, and have friends. They want to have leisure time and eat well. They all want something.

They share all the same traits that make us human. People everywhere are humble and vain, generous and greedy, wise and foolish, and many other qualities besides. They've made mistakes. They have hopes and dreams.

Yet great disparities and differences exist, too. Since the Industrial Revolution, the Western world—mainly the United States and Western Europe—has vaulted well ahead of everyone else. Traditionally wealthy economies, such as China and India and parts of the Middle East, were left far behind. The Western world dominated—in manufacturing might and in military power, especially.

This gap probably reached its apex sometime in the 1950s. According to *Power and Plenty*, a good reference book on trade, the Western world (excluding Japan) represented 90 percent of the world's manufacturing output as late as 1953. The United States bestrode the globe as Tiger Woods once lorded it over golf's majors. America's economy alone was nearly half of the world's industrial output.

But things started to change in the late twentieth century. The gaps narrowed. And these trends continue to unfold in the present. My thesis is that such narrowing of the gaps will continue for decades. This will be the most important long-term investment theme of the twenty-first century.

I call it "the world right side up" because it is, in my mind, a more natural world, more the way the world ought to be. It's a Western conceit to think that the current technical, economic, and military superiority of the West is normal. When you look at the history of our planet over a longer time frame, the dominance of the West is a relatively recent affair.

The Polynesians had prosperous farming villages across a great swathe of the South Pacific while Europeans were still living in caves. In double canoes, using only the stars and their wits, Polynesians crossed distances as great as those of Columbus thousands of years before Christ was born. And of course, you surely already know the long list of inventions first made by people in China or Arabia.

The distinctions between "emerging markets" and "developed markets" are starting to disappear. Indeed, the term may already be obsolete. Such is the thesis of Everest Capital, which made the case in a white paper called "The End of Emerging Markets."

First, in terms of size, these emerging markets make up about half of the global economy. Take a look at Figure 1.1. GDP, or gross domestic product, is a flawed statistic, but it serves as a rough guess of economic size. "Purchasing power parity" (PPP) aims to take out the distorting effect of different currencies.

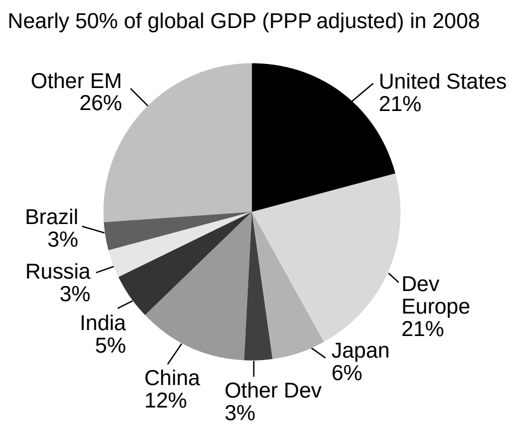

FIGURE 1.1 Let's Call It Even

Source: Everest Capital.

This is astonishing, but the comparisons get more interesting by country. Emerging markets make up 10 of the 20 largest economies in the world. India is bigger than Germany. Russia is bigger than the United Kingdom. Mexico is bigger than Canada. Turkey is bigger than Australia. These are things that I think would surprise the casual observer of markets, rooted in a Western view of the world as it was.

These trends will become more pronounced over time. The creation of new markets, the influx of hundreds of millions of people who will want cell phones and air conditioners and water filters, who will want to eat a more varied diet of meats and fruits and vegetables, among many other things, will have a tremendous impact on world markets. In fact, we've felt the impact in many areas, as we'll see.

In these pages, I'll focus on where these markets have been, where they are, and where they're headed. It is, necessarily, an eclectic and idiosyncratic look at the world. The world is still a big place. There are many patches of Earth and stretches of sea where I've never set foot. They are many places I don't write about here. This is not a comprehensive guide to global markets. It is one curious investor's sampling of that world.

That world is always changing. I first visited Dubai in 2007, when it was a boomtown. Buildings were going up everywhere. Trucks filled the highways. Cranes crowded the skyline. I learned later that two-thirds of the world's cranes were in Dubai back then. It had all the buzz and confidence of boomtowns I've seen in many other places.

My second trip was in October 2009, when everything was bust. It was a completely different place. There were still cranes, but they weren't moving. The many construction sites were still there, but there was no activity on most of them. The place was dead. The third palm island dredged out of the Arabian Gulf—it's never the Persian Gulf in that part of the world—wasted away in the waves and wind.

That's part of the business. Just when you think you've got a bead on a place, something happens that forces you to revisit all you thought you knew.

But the broader narrative never changes. The rest of world is catching up. That's the overwhelming tidal force in markets, and one that will continue to surge on its shores well into the twenty-first century. (Dubai is coming back, slowly, but surely. It's not going away; we'll take a look in Chapter 7).

The evidence is all around us, as you'll see in these pages. Every day, I find new snippets of it as I peruse the *Wall Street Journal* and the *Financial Times*. As I travel and meet people and research new investment ideas, I am confronted with this narrowing gap again and again. These experiences inspired this book.

The key idea is simply that the Industrial Revolution set off a yawning gap between the "West" and the "rest of the world." That gap is shrinking and will continue to shrink. Don't be afraid of this change. All is as it should be. The aberration was the last 200 years. The anomaly was that China, in 1970, had an economy smaller than that of Belgium. For hundreds of years before that, it was the world's largest economy.

It may already be on top again.

Arvind Subramanian, a senior fellow at the Peterson Institute, makes the case that China's economy is already the largest in the world, passing the United States in 2010. "On this basis," he writes, "the average American is 'only' four times as wealthy as the average Chinese, not 11 times as rich, as the conventional numbers suggest."

It might seem funny to you that we can't to seem agree on how big economies are. But it is not easy to estimate the size of something that doesn't sit still—so you can count it—and that consists of billions of transactions. All of these things are estimates, but the impact China's had on the global economy is real and not in doubt. We'll take a look at China in Chapter 5.

I stay away from statistical abstractions like GDP. What is GDP, or gross domestic product, exactly? What does it mean, and why should we care? The truth is there is an awful lot of guesswork in such figures, and they are not practical. You could lead a very successful and rich life as an investor and never know a thing about GDP figures.

In this book, I will stay away from such economic monstrosities as much as possible. This book is a boots-on-the-ground view, a first-hand look. It's more practical, and the aim is to stay close to what is happening and what we can understand in more tangible ways.

For instance, we may debate the size of China's economy—as many people spend an inordinate time doing—but don't doubt its impact. Take a look at Figure 1.2 to see the tangible impact of the growth of China on commodities.

So it is impossible to be an investor in iron ore, coal, or wheat without considering what's happening in China.

In any event, my view here is that we are headed back to a world more in line with a "normal" historical perspective. It is a world right side up.

The work of Angus Maddison, the late British economist, offers this helpful illustration. Again, I am skeptical of the ability to measure economic size in general—much less for, say, 1600—but I think Figure 1.3 makes intuitive sense.

During the Song Dynasty (960–1279), for instance, the capital city of Hangzhou had a population over a million people. It was one of the world's most advanced cities. Lars Tvede describes it in *Supertrends*:

> *Here you could find hundreds of restaurants, hotels, and theaters. There were tea houses with landscaped gardens, large colored lamps, fine porcelain, and calligraphy and paintings by famous artists. The night-life was rich and varied, and there were professional puppeteers, sword swallowers, theater actors, acrobats, musicians, snake charmers, storytellers, and whatnot. People with special interest could join exotic food clubs, antiquarian and art collector clubs, music clubs, horse-loving clubs, and poetry clubs. All of that about 1,000 years ago.*

So, in some ways, the seemingly sudden and unprecedented boom in China is more a return to what was, when Chinese cities were among the largest and most advanced in the world. It's not there yet, but to anyone who's walked the Bund in Shanghai or seen the gleaming new airport terminal in Beijing or even visited the modern fashion shops in today's Hangzhou, you see the trend unfolding.

I mentioned Everest Capital's white paper earlier. It points to a few more ways in which you see how the gaps are closing.

One is to look at simple liquidity. Not that long ago, the value of IBM shares changing hands in a single day in New York were worth more than all the shares that traded hands in Shanghai or Bombay on a given day. No more.

China's consumption of select commodities,
as a percentage of world consumption

Commodity	**China % of World**
Cement	53.2%
Iron Ore	47.7%
Coal	46.9%
Pigs	46.4%
Steel	45.4%
Lead	44.6%
Zinc	41.3%
Aluminum	40.6%
Copper	38.9%
Eggs	37.2%
Nickel	36.3%
Rice	28.1%
Soybeans	24.6%
Wheat	16.6%
Chickens	15.6%
Oil	10.3%
Cattle	9.5%

FIGURE 1.2 China: Hungry Dragon

Source: Barclays Capital, Credit Suisse, Goldman Sachs, U.S. Geological Survey, BP Statistical Review of World Energy, Food and Agriculture Organization of the United Nations, IMF.

	Western Europe	Former Soviet Union	United States	Japan	China	India
1500	17.9%	3.4%	0.3%	3.1%	25.0%	24.5%
1600	20.0	3.5	0.2	2.9	29.1	22.5
1700	22.5	4.4	0.1	4.1	22.3	24.4
1820	23.6	5.4	1.8	3.0	32.9	16.0
1870	33.6	7.6	8.9	2.3	17.2	12.2
1913	33.5	8.6	19.1	2.6	8.9	7.6
1950	26.3	9.6	27.3	3.0	4.5	4.1
1973	25.7	9.4	22.0	7.7	4.6	3.1
1998	20.6	3.4	21.9	7.6	11.5	5.0
2008	17.1	4.4	18.6	5.7	17.5	6.7

FIGURE 1.3 Shifting Mix of Global GDP

Source: Morgan Stanley Research.

Today's emerging markets are large and liquid. As Everest Capital pointed out at the time of its report, "Chinese markets (granted, there is a lot of retail turnover there) traded more than the NYSE; Hong Kong and Korea traded more than Germany; India traded more than France; and Taiwan traded more than Italy, Australia, or Canada."

Others see shifting changes in the world's financial markets. My colleague and friend, Eric Fry, at *The Daily Reckoning*, pointed out a few in a piece titled "A Shrinking Distinction."

"The First might become last . . . and the Last, first" Fry wrote. "Generally speaking, the mature economies of the West are slipping, relative to many emerging economies around the globe. The First have not become last just yet, but they are working on it."

He pointed to the five-year credit default swap (CDS) on AAA-rated French government debt as compared to that of Chile's AA-rated debt. (A CDS is a kind of insurance against default. The higher the risk, the higher the price of the CDS.) Remarkably, Chile's CDS rate was lower.

This is not an isolated event; it is of a piece of what's going on all over. The CDS rate on French debt was higher than Brazilian, Peruvian, and Colombian debt. That would've been unimaginable 10 years ago! All three of the latter countries carry BBB-ratings, too, one notch above junk. But the market renders its own judgments, ahead of and more accurately than ratings agencies.

"Ten years ago," Fry continues, "Portugal, Ireland, and Greece were highly rated sovereign borrowers. Ireland was AAA. Meanwhile, Brazil, Peru, and Colombia were all 'junk credits.' Figure 1.4 below shows what has happened since. Today, Brazil, Peru, and Colombia are all investment grade, while Portugal, Ireland, and Greece are all junk credits."

And over this time frame, the stock markets of Brazil, Chile, and Colombia trounced the Europeans' as you can see in Figure 1.5.

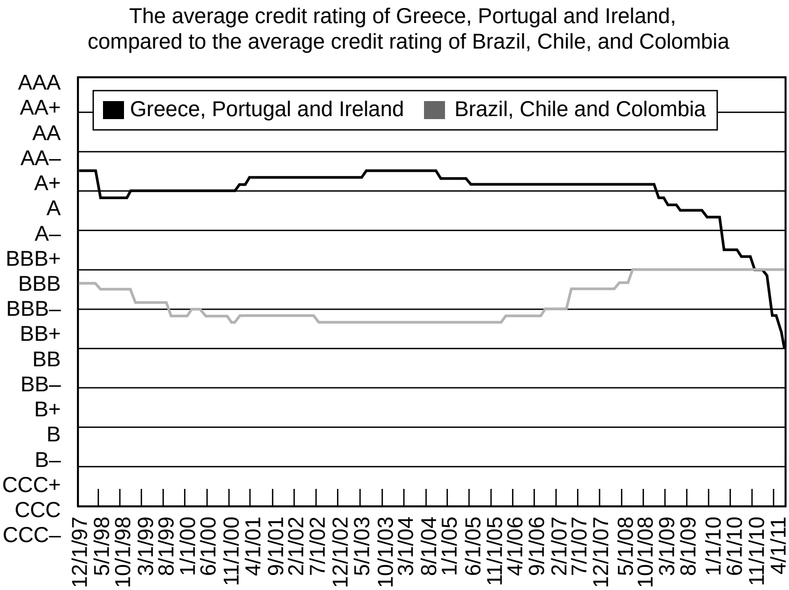

FIGURE 1.4 Submerging Markets

Source: AgoraFinancial.com.

FIGURE 1.5 World Markets Turn Right Side Up

Source: AgoraFinancial.com.

"This glimpse into the past," Fry offered, "will also be a glimpse into the future. Capital flees from abusive relationships and seeks out environments where it can be fruitful and multiply."

That is a core truth of wealth creation. That truth drives the world's financial markets to turn right side up.

Everest Capital's exhibits should shake off doubt from even the most moss-backed investor. The brontosaurus's lagoon is no longer his alone. His world has changed. He must compete with new furry and nimble animals.

Beyond this, Everest continues to clear away old attitudes as a man with a broom sweeps away cobwebs. For instance, "The belief that companies in the United States, Western Europe, or Japan are better managed than in emerging markets is also no longer valid. We meet a large number of managements in emerging market countries, and it is impressive to see how quickly they have adopted the best practices in terms of disclosure, governance, and creating shareholder value."

Supercycles: Where We Are Today?

I am not the only one who has picked up on this idea, which is broadly applicable to many areas of investing. For instance, in early 2011, I attended the 49 North Resources conference in Manhattan, meeting with mining companies and gathering intelligence. I heard mining strategist Christopher Ecclestone give a talk titled "A Mining Supercycle?"

I thought to myself: "Of course, he'll say we're in a mining supercycle and how wonderful mining is. I'm at a mining conference, for crying out loud, surrounded by mining companies and geologists. To expect otherwise is like walking into a Star Trek convention expecting to hear a guy talk about how dumb the whole show was."

Yet he surprised me. He said no, this isn't a mining supercycle. In fact, he turned the idea on its head. What he said folds neatly into our world right side up idea.

As you know, commodities have been going up in recent years, everything from copper to coal. It's getting harder to find big deposits of some of this stuff, and what we find is more expensive to dig out.

The Chinese get what's going on. They are securing supplies of those key resources of which they consume so much. So they're making deals with Brazil, all over Africa, and in a bunch of other places.

Ecclestone had a good line about the Chinese. He said they are more interested in natural resources than they are in intellectual property "because they know they can rip those off. It's harder to rip off a coal mine."

But Ecclestone's main point is that what we're seeing isn't anything new. It's not a new supercycle for mining. It's a return to normal. The aberration, he said, was the period from 1973 to 2003, when mining experienced its dark age.

The aberration was the kind of thinking that took natural resources for granted. "Metals and agricultural commodities were the epitome of cheap—regarded with some contempt as common and plentiful," he said. "The apogee of this disdain for minerals was during the tech boom."

Then, an immaterial service-oriented company like Pets.com could command a market cap of billions of dollars. You could've bought any number of mining companies for a fraction of that. "Today, Pets.com has evaporated into thin air," Ecclestone said, while the mines remain and are very valuable.

The 1973–2003 time frame "was a calamitous period for miners and commodity producers," he continued. "The only commodity for which the sun shone was oil, and even then the late 1990s were gruesome."

There was a brutal thinning of the herd of mining companies, particularly in the 1990s and particularly in the United States. During this time, we "lost" major mining companies—Anaconda, Kennecott Utah Corp., Magma Copper, Asarco, and many others. "And these were just the big ones," Ecclestone added. The mid-size and smaller miners were almost wiped out. We saw the "virtual annihilation of the U.S.-listed mining sector."

Metals became loss leaders. Capital spending fell. Exploration came to a near halt. Most of the mines in Africa closed. Miners also shut down many marginal or low-grade mines. Instead, they focused on the highest-grade ore, the low-hanging fruit of the mining world, just to stay alive.

Why did this happen?

Ecclestone cites a number of reasons that combined to create a kind of perfect storm. The postwar period created a proliferation of mega mines. China, too, became a low-cost producer of a number of metals. It has come to dominate certain sectors entirely (such as zinc and rare earths). Many mines in Africa and South America fell under state control. These states operated them without regard to economics. Later, the Soviet Union's industrial base collapsed, releasing a lot more commodities on the market. And Cold War stockpiling of metals stopped and reversed, releasing even more supply on the market.

But Ecclestone says, we are returning to something that more closely approximates what prevailed for a much larger slice of history.

The normal state is one that understands and recognizes the value of mineral commodities. The normal state is one in which the producers of these useful rocks and metals earn rewards for the risk and ownership of scarce resources.

Today, no new mega mines exist. The stockpiles are dwindling. That low-hanging fruit is gone. Today, for example, copper miners have to dig up 50 percent more rock than they did in 1994 to get the same amount of copper. And demand continues to grow apace.

An example of that demand is copper production going all the way back to 1900. Take a look at the nearby chart. Copper is not an exception. You can make the same point with any number of metals. "Where are the downturns in this?" Ecclestone asked showing a version of Figure 1.6. They are comparatively minor and short in a long climb upward. "There is no reason to think copper use shouldn't go onward and upward."

Far from being a special case or an outlier, the growing use of commodities looks normal against a long time series.

As commodities get more expensive, we'll have to change how we use and apply them. "If a lot of commodities get too expensive, then you have replacement and rationing," Ecclestone said. We could see this soon, as commodities price themselves out of some markets. Boeing opened a window into this future with its announcement that it is considering making the 737—the most widely flown commercial jet—out of plastic.

Ecclestone predicts that when it comes to some metals (lead, for example), recycling will largely replace the need for mining. "In rare earths," Ecclestone offered by way of example, "there is little recycling, but there will be more recycling soon."

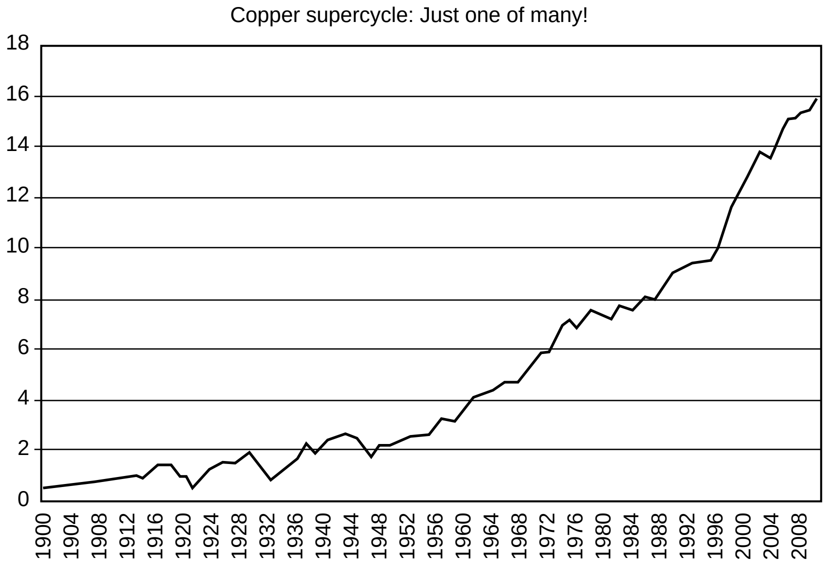

FIGURE 1.6 Find the Downturn

Source: Christopher Ecclestone.

Many interesting investment ideas spin off these last few paragraphs that are not necessarily mining related, but more about specialty materials and getting more out of what we have. A key investing theme for the next decade is how to make materials that make things more efficient, better, and/or longer lasting. There will be many such opportunities.

Even so, the business of mining will remain vital for many commodities. Ecclestone summed up: "[What we are seeing] is a reversal of the late 20th-century trend, which gave all the value to the service and intellectual property. . . . The whip hand is back with the owners of the inputs."

Our present age is not so much a new era as a return to a more historical norm. Another way to see this is to look at trade.

World's Economy Is Bigger—and More Open—Than Ever Before

In a little white-walled Spanish-style cottage overlooking a spectacular beach in Nicaragua, I presented to a small group of investors. I shocked them by saying this: The world's economy is twice the size it was a decade ago.

Think about that. Despite all the bad stuff that has gone down in recent years—including a big financial crisis and the ensuing recession—the global economy is nearly double what it was only 10 years ago!

Living in the United States (or Europe or Japan), one might wonder how that could be. Obviously, these economies didn't grow that much. Instead, most of the action is beyond the borders of these mature economies, which has a lot to do with why I was in Nicaragua in the first place.

We live during a time that future historians will cite as a hinge in the history of markets. For the first time since before the Industrial Revolution, the so-called emerging markets will be bigger than the Western countries (including Japan). This gap will widen as emerging markets continue to grow faster.

Global trade, too, is more important than ever. "The Super-Cycle Report" is a fascinating research piece put out by Standard Chartered. It shows us just how important global trade flows have become. In fact, global exports are nearly at their prerecession peaks.

Trade made the explosive growth in the world economy over the last 10 years possible. China goes nowhere without its ability to trade for commodities abroad, and Brazil goes nowhere without the ability to supply them.

Trade has been a fertilizing influence since time immemorial. Think of the camel trains laden with silk, indigo, and jewels, making their way across the land mass of Asia to the cities of the West in ancient times. Think of the old galleons under starry skies carrying spices and gold during the age of sail. What a different world it would be with closed borders.

Today, the world is more open than it has ever been. One way to see this is to look at exports as a percentage of the global economy. Today they are at all-time highs.

As an investor, it's been the right call to focus on companies that had exposure to rapidly growing markets overseas. This happy circumstance is something to keep an eye on because trade ebbs and flows. In 1945, for instance, trade was 40 percent below the level of 1913. How did that happen? Let us count the ways: two world wars, the fall of the Austro-Hungarian and Ottoman empires, hyperinflation in Germany, the Great Depression, and the demise of the gold standard. It was a tough 30 years.

The emerging markets still have a lot of catching up to do, which should power expanding trade for years to come. Standard Chartered points out that China's per capita income is still only 9 percent of the United States', or about where the United States was in 1878. If it were to get to half of the United States' total, China's economy would be twice the size of the United States'. Then consider Indonesia—the world's fourth most populous country. It has a per capita income only two-thirds that of China.

Don't underestimate the ability of a poor country to grow very rapidly for a long time under the power of open markets. The authors of the report note: "Since 1945, every country recognized for outstandingly rapid development has achieved 7 percent growth for twenty-five years or more, including China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Singapore, and Thailand."

There are new contenders for the years ahead. Standard Chartered created a "Seven Percent Club." These are countries it estimates will grow 7 percent a year over the next 10 years—doubling in size. These happen to include almost half of the world's population. They are China, India, Indonesia, Bangladesh, Nigeria, Vietnam, Ethiopia, Tanzania, Uganda, and Mozambique. Others that ought to grow fast but will likely fall short of the 7 percent mark include Russia, Brazil, Pakistan, Mexico, the Philippines, Egypt, Turkey, and Korea.

Plenty of rich patches of Earth still exist where the pixie dust of the Industrial Revolution never fell or never really got to do its thing. China was, by far, the world's largest economy until the nineteenth century. It was left behind thereafter but is catching up again.

One of the effects of this second Industrial Revolution is that more and more people live in cities. By 2030, the authors of the report guess that 60 percent of the world's population will be urban dwellers, compared with only 29 percent in 1950.

"Historically, commodity consumption has significantly increased as annual per capita income approaches a level deemed 'middle class,'" the authors continue. "The next 20 years will bring an unprecedented increase in the number of people living in cities (close to 5 billion people will live in cities by 2030, compared with 3.4 billion). . . . [with] an equally significant increase in the size of the global middle class (from 1.8 billion in 2009 to about 5 billion in 2030)."

As an investor, your mouth should be watering. Think of what so many new consumers mean for businesses ranging from beer brewers to financial services companies. Consumers will use more stuff, eat more food, and use more water. They will buy more TVs, laptops, motorcycles, cars, and mobile phones.

The Old Silk Road and the New

> *To follow the Silk Road is to follow a ghost. It flows through the heart of Asia, but it has officially vanished. . . .*
>
> —Colin Thubron, *Shadow of the Silk Road*

A powerful metaphor that describes what is going on is the Silk Road. Its ghostly trade routes are reawakening.

The old Silk Road was not even a road in the normal sense of that term. It was, as travel writer Colin Thubron describes it, "a shifting fretwork of arteries and veins, laid to the Mediterranean." Thubron covered 7,000 miles in eight months following the old trails of this fabled trade route.

The Silk Road stretched from Antioch, Turkey, all the way to old Chang'an, or what is today known as Xi'an, in China. For a long time, it had no name. A German geographer coined the term "Silk Road" in 1877.

Yet traffic along the Silk Road goes way back into the slipstream of humanity's past. Thubron writes: "Chinese silk from 1500 B.C. has turned up in tombs in north Afghanistan, and strands were discovered twisted into the hair of a tenth-century B.C. Egyptian mummy." Archeologists found silk dating from 1100 B.C. lying in the grave of a prince in Germany. The stuff got around.

The Silk Road carried much more than just silk across its rugged landscape. From China, the West got jade, lacquer, ceramics, the first roses, azaleas, as well as oranges, peaches, mulberries, apricots, and rhubarb. Coming from the West to the East came glass, gold, silver, Indian spices, gems, and linen along with fig trees, flax, pomegranates, jasmine, dates, and olives.

Back and forth went vegetables, fruits, furniture, artifacts of all kinds, musical instruments, even slaves and weapons. The crossbow, a Chinese invention, made its way across the old Silk Road to arm the Norman and Capetian kings in their battle with the dreaded English longbow at Crécy (in which they were famously defeated).

The old Silk Road embraced almost every national and ethnic group from Arabia to Japan, including Persians, Turks, Sogdians, Syrians, Indians, and many others. (Often called the greatest Silk Road traders, the Sogdians were an Iranian people. The Chinese thought them born traders. Myth held that "their mothers fed them sugar to honey their voices, and their baby palms were daubed with paste to attract profitable things," writes Thubron.)

None of them made the journey the whole way through. No Roman ever walked the streets of Xi'an or visited the tomb of the Yellow Emperor. No Chinese trader ever gazed upon the pillars of imperial Rome or dipped his toes in the Mediterranean Sea.

Instead, the Silk Road was more like a long relay race. Only luxury items could generally make the whole journey—the jade and the silk, for example—or perhaps incidental items people carried with them, like a flute or an old trader's pipe. It was simply too expensive to ship most things the whole distance, except those things for which people were willing to pay a heavy price.

Still, the old Silk Road was the dominant trade route in human history for over a thousand years. Its importance diminished only sometime in the sixteenth century, when ships replaced the harrowing journey overland and transported goods much cheaper and faster.

There is a Silk Road revival, though, at least metaphorically. The old trading posts worked in storied cities such as Samarkand, Kashgar, and Meshed. The new Silk Road weaves through Dubai, Riyadh, through Mumbai and Chennai in India, to Kuala Lumpur, Singapore, Hong Kong—even as far as Tokyo.

Like the old Silk Road, the new one is not a road, either. But it's a great way to describe the surge in trade between the Middle East and Asia. From 1995 to 2005, trade between these two regions increased fourfold, according to McKinsey & Co. Projections call for trade between the six members of the Gulf Cooperation Council (GCC)—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates—and East Asia to explode from $59 billion to $300–500 billion by 2020.

Rapidly growing Asian economies have, at least in part, driven demand for oil. Higher oil prices in recent years mean overflowing GCC coffers. They need to put that treasure to work. More and more, it is winding up in Asia.

It's a feedback loop. More growth in Asia means more demand for oil—with more and more coming from the Middle East. By 2030, estimates put half of China's oil imports coming from the Middle East. Asia—including India—could account for half the increase in the world's demand for oil. That means more cash for the GCC and more investment in Asia—in real estate development, banking, communications, and infrastructure.

In the meantime, Chinese, Indian, and other Asian companies are active in the Middle East. They bring low-cost consumer goods (Dubai is already home to Chinamexmart, which McKinsey describes as a "mini-city of Chinese companies distributing their products throughout the region"). Asian companies also bid on major construction projects in the Middle East.

Travel traffic is a great barometer of economic activity. As late as 2000, there were only seven daily flights between the Gulf states and China. Today, there are over 50.

Thubron notes on his trip how the influence of the old Silk Road flowed into even remote hamlets. "The nervous system of the Silk Road radiated into the poorest extremities," he writes. "It traversed minor ecological divides, as well as empires."

One economist who has a lot of this figured out is Ben Simpfendorfer. His excellent study of this re-emergence of trade with the Arab world and China is *The New Silk Road: How a Rising Arab World Is Turning Away from the West and Rediscovering China.*

Simpfendorfer's Arabic and Mandarin served him well in his 15 years traveling the New Silk Road from Beirut to Beijing. He got stories straight from individual traders and actual people.

I met up with Ben one day when he was in Washington, D.C., and we talked about the changing world, appropriately, at a fusion restaurant. We've since struck up a correspondence. (You can follow Ben's adventures in his newsletter called *China Insider.*)

One of his most memorable meetings is with a wealthy Syrian trader in Damascus. They meet in a ramshackle 500-year-old office. "Wooden barrels filled with spices and sweets spill out into the streets," he writes. "The air is rich with the scent of olive soap and musky perfume." The stalls here have been hawking their wares for centuries, and today, more of these wares come from China.

He meets with other businesspeople in Yiwu, Cairo, Beijing, and many other cities, all offering human-level portraits of this New Silk Road. Change is happening at the grassroots level. "Who notices the activities of an Arab trader in Yiwu or a Chinese trader in Damascus?" he writes. "It isn't obvious how their activities have a meaningful impact on life in America and Europe." But this is how major changes begin, with smaller changes at the margin.

Dubai, for example, houses the Dragon Mart. It is the largest building to sell exclusively Chinese-made goods outside of China. It measures nearly 1.6 million square feet. And China seems to go out of its way to make Arabs feel at home in China, even using state money to build mosques. According to the book, the Chinese will issue visas for visiting Egyptians in 24 hours. It takes 18 days for an Egyptian to get one for America. This is just another among a string of many similar anecdotes.

In the bigger-picture sense, oil drives the strengthening of these ties. China needs lots of oil, and the Arab oil producers have it in spades. Arab oil producers and Iran produce 30 percent of the world's oil; the IEA projects that number will rise to 38 percent by 2030. Much of it will wind up in China.

China flipped to becoming a net oil importer in 1993 and has never looked back. It is the world's fifth-largest producer of oil, but its ability to produce oil lags its own demand by a long way. It is the second-largest consumer of oil, behind only the United States.

Thanks to higher oil prices, the Arab oil producers have staggering amounts of wealth. The task of investing all of that money falls on the Arab wealth funds. These pools of money are market movers.

The Arab wealth funds are very active in non-U.S. markets. Their big purchases reveal a pattern: Djibouti, Guinea, Kenya, Malaysia, and Pakistan, for instance. Arab wealth funds are also active buyers of Chinese stocks.

On Monsoon Seas: A Glimpse of the Future

There's a second way to look at the New Silk Road: its maritime aspect. Here again, we see a revival of an old trading pattern with consequences for today.

The Indian Ocean is one of the world's great trading seas. It was the seaway for the old windblown argosies laden in spices and silk and much more. Kuwaiti booms, double-ended dhows, little sambuks from the Red Sea, and many more vessels sailed these waters to trade along its rim.

If you ever want to learn more about this storied history, turn to Alan Villiers (1903–1982), a writer and adventurer from Melbourne, Australia, who traveled all around the Indian Ocean.

His dossier is extensive, with voyages up and down the Persian Gulf, the Red Sea, and along the coast of East Africa. A decorated officer in World War II, he oversaw landing craft in the Burma campaign, among other accomplishments. Over the years, he became quite a student of the Indian Ocean's history and geography. I have his 1952 book, *Monsoon Seas: The Story of the Indian Ocean.*

In it, he writes, "The Arab, the Indian, and the Chinese have been ubiquitous merchants and fearless wanderers far longer than it is possible to say." The monsoon seas were often cheaper and quicker and sometimes safer than overland, where you often had to pay tribute as you went. "The west winds could blow a square-rigged ship from Good Hope to Australia in three weeks and less" Villiers notes, "though the distance is 6,000 miles."

It was, in part, the rise of seaborne trade that doomed the old overland Silk Road.

Villiers also weaves in his own experiences with rich descriptions that stay with you. Zanzibar is where the "scent of cloves and . . . salted shark is