Global Equities

Companies, Not Countries: Investing in an Uncertain World

Practically everywhere you look today, there seems to be some kind of national crisis. Europe is still trying to contain its sovereign debt issues. Japan is just beginning to recover from natural disaster. The U.S. is struggling against stiff economic and political headwinds. And many emerging markets are trying to contain high inflation without compromising growth. Despite such challenges, each of these areas offers potentially outstanding opportunities for informed investors.

George Evans
Director of Equities

In this issue, Director of Equities **George Evans** and Client Portfolio Manager **Alice Fricke** explore

- Why even currently unappealing countries may be home to strong business propositions
- Why investing in companies, not countries, is essential to successful global investing
- Several case studies of global companies thriving in an increasingly borderless marketplace, regardless of whether their home country is in good shape

Alice Fricke
Client Portfolio Manager

Look Past Macro Concerns to Find the World's Best Companies

George Evans, Director of Equities, and **Alice Fricke,** Client Portfolio Manager

Throughout 2011, markets have been punishing Greece, Spain, Portugal, Ireland and, most recently, Italy, for excessive debt levels and the lack of a clear, coordinated European response to the crisis. The U.S. faces tepid growth, high unemployment and swollen debt levels, compounded by deep political divisions that, as in Europe, impede a coordinated response to its malaise. Japan is just beginning to rebuild from the destruction wrought by the tsunami, earthquakes and nuclear disaster in March. Meanwhile, many emerging markets are still working to tame high inflation without unduly hampering growth, and political upheaval continues to sweep the Middle East and North Africa, home to vast oil reserves on which the rest of the world depends for energy.

To look at the headlines, one might think that there were relatively few attractive places to invest today. That view would be mistaken. While many countries do face daunting challenges, equity investors do not invest in countries or regions—and shouldn't think as if they do. A little over a year ago, as the financial world was coming to grips with Greece's economic troubles and the U.S. was entering a summer soft patch, we wrote that "while macro trends are important to understand, they should not be of paramount concern to equity investors, who are better served by focusing first and foremost on individual companies' cash flows and business models" ("Cash Flow Before Country," *Capital Markets Perspectives*, May 2010). That's just another way of stating one of OppenheimerFunds

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The Right Way to Invest

Global team's guiding principles: *Companies, Not Countries.* And given the current state of global macroeconomic affairs, it's perhaps an even more relevant statement today than it was last year.

As investment managers, we're not particularly concerned with where a company's headquarters are; we care where its customers are, and whether the company is well positioned within the global marketplace to deliver long-term growth. In particular, we look for firms that may benefit from several powerful, long-term global themes: mass affluence, new technology, restructuring and aging (collectively known as our "MANTRA"®).

Case Studies[1]

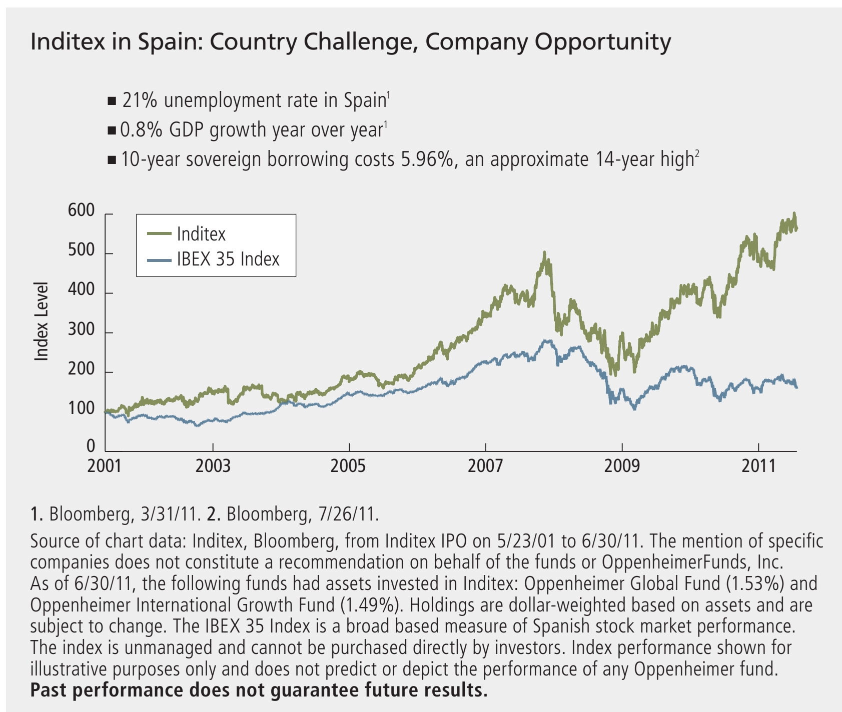
To better understand the advantages of focusing on companies instead of countries, let's examine several firms that are thriving, despite being headquartered in nations facing macro difficulties: Spain, Italy, Japan and the UK.

Inditex: When investors think of Spain these days, soaring bond yields, high unemployment and mass demonstrations are probably the first things that spring to mind. But Spain, the fourth-largest economy in the Eurozone, is also home to Industria de Diseño Textil, S.A., or Inditex, which designs, manufactures and distributes apparel, primarily through its chain of more than 1,700 Zara stores.[2] These outlets are spread throughout Europe, the Americas, Asia, Australia and the Middle East. Roughly 30% of Inditex's revenues come from the Spanish market and, despite weak local economic conditions, Inditex consistently generates a profit there.[2] However, the firm derives the rest of its revenues from much more widely distributed sources, with only four countries providing more than 5% of sales each, and only 16 countries providing more than 1%.[2] As a result, we believe the company is well insulated from the crises now rocking Spain. Inditex also has plenty of room to grow; market share in Spain is estimated at 11–12%, but, with the possible exception of Portugal, Inditex has less than a 1% market share in every other country in which it operates.[2]

CHART 1

Inditex in Spain: Country Challenge, Company Opportunity

- 21% unemployment rate in Spain[1]
- 0.8% GDP growth year over year[1]
- 10-year sovereign borrowing costs 5.96%, an approximate 14-year high[2]



1. Bloomberg, 3/31/11. **2.** Bloomberg, 7/26/11.

Source of chart data: Inditex, Bloomberg, from Inditex IPO on 5/23/01 to 6/30/11. The mention of specific companies does not constitute a recommendation on behalf of the funds or OppenheimerFunds, Inc. As of 6/30/11, the following funds had assets invested in Inditex: Oppenheimer Global Fund (1.53%) and Oppenheimer International Growth Fund (1.49%). Holdings are dollar-weighted based on assets and are subject to change. The IBEX 35 Index is a broad based measure of Spanish stock market performance. The index is unmanaged and cannot be purchased directly by investors. Index performance shown for illustrative purposes only and does not predict or depict the performance of any Oppenheimer fund. **Past performance does not guarantee future results.**

One of the keys to Inditex's success is the nearly legendary speed with which it can move items from the design board to the store rack using an industry-leading combination of information technology and local sourcing. Unlike many competitors, whose goods are made in Asia, the bulk of Inditex's products are made close to its headquarters and design centers in northern Spain. As a result, it can produce and alter design prototypes very rapidly, and profitably produce and sell smaller, more market-specific product runs. When Kate Middleton, Duchess of Cambridge, wore a Zara dress in her first public appearance following the royal wedding, the dress quickly sold out worldwide. However, Inditex was able to manufacture and ship another order of the garment in just two weeks.

Such efficiency, enabled by an embrace of new technologies, has brought rewards. During what has been a very challenging period for most retailers—and for Spain—Inditex has managed to generate solid returns for shareholders. (See Chart 1)

BBVA: BBVA (Banco Bilbao Vizcaya Argentaria, S.A.) is a major full-service bank also based in Spain, but with significant banking operations in Latin America. These operations give it access to vast numbers of

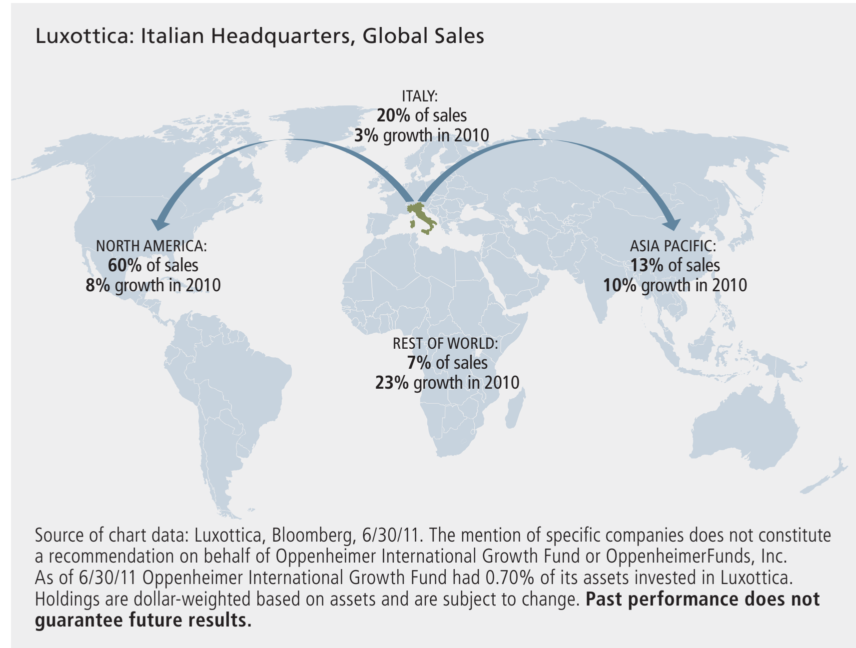
increasingly affluent emerging market consumers and help the company dilute its direct exposure to the effects of the European sovereign debt crisis. BBVA's shares sold off in July, along with shares of most other Spanish banks, on generalized concerns over the crisis and the European Banking Authority's bank "stress tests." Perhaps, in BBVA's case, the market threw the baby out with the bathwater. The recent declines in the stock may represent an opportunity to buy shares in a high quality bank whose Spanish franchise is on sale, and whose Latin American business is being offered essentially for free, in our view.

While five of the eight banks that failed the stress tests were Spanish, the country's largest banks passed—including BBVA—because they had some of the strongest capital levels in the European Union. Historically, in fact, the banking market in Spain has been very attractive. Spanish banks typically enjoy lower operating costs and higher retail margins than those of their developed-market peers, owing to policies that require every individual and business entity to have a bank account. Spain is forcing consolidation in its banking sector, and we believe BBVA appears well positioned to increase its market share significantly.

Luxottica Group: Luxottica, an Italian company, has been relatively sheltered from the contagion fears swirling around its home country as the European sovereign debt crisis broadens. And well it should be; its eyewear manufacturing and distribution operations are globally diversified. Luxottica is one of the largest manufacturers of eyeglass lenses in the world. Its portfolio includes popular brands such as Ray-Ban and Oakley. It also operates a wholesale network that involves 130 countries, and manages global retail chains such as LensCrafters and Sunglass Hut. Luxottica is strategically positioned to benefit from two long-term growth themes affecting both developing and developed markets: rising wealth in emerging markets and an aging global population. As discretionary spending grows in these markets, consumers are likely to seek products that help deliver a better quality of life. Aging consumers are also likely to drive increased demand for corrective lenses, as their eyesight deteriorates with age. Given such tailwinds and the fact that Luxottica's customers are located all over the world, the fact that the company is headquartered in beleaguered Italy is almost irrelevant in our view. (See Chart 2)

CHART 2

Luxottica: Italian Headquarters, Global Sales



Source of chart data: Luxottica, Bloomberg, 6/30/11. The mention of specific companies does not constitute a recommendation on behalf of Oppenheimer International Growth Fund or OppenheimerFunds, Inc. As of 6/30/11 Oppenheimer International Growth Fund had 0.70% of its assets invested in Luxottica. Holdings are dollar-weighted based on assets and are subject to change. **Past performance does not guarantee future results.**

Nidec, Inc: Nidec makes precision electric motors used in hard disk drives. Though the company is headquartered in Japan, its manufacturing facilities are spread throughout Asia and its customer base is spread across the globe. As a result, when the recent earthquake and tsunami hit Japan—and a sizeable swath of Japan's industrial base—Nidec was not significantly affected.

Nidec's electric motors are used in large memory devices, which are becoming ubiquitous globally. An array of electronic devices is being fitted with ever-larger hard drives to store information. Every one of these hard drives requires a precision electric motor to read and write data, and Nidec has a full 80% share of the hard-drive market.[3] Long-term growth prospects look attractive, too, as the firm stands to potentially benefit from the exploding global growth of data usage.

Finding enough storage capacity for all this data will present a challenge—and an opportunity. Good investments, we believe, are often found at the "choke points," or capacity constraints, of major growth phenomena. In the case of data, the primary choke points are delivering it, managing it and storing it. When it comes to data storage, we believe Nidec could hardly be positioned more advantageously.

Burberry, Inc.: Burberry is an iconic brand that has imaginatively leveraged its trademark plaid fabric and made much of its quintessential "Britishness" to become a global apparel powerhouse—and transcend the economic difficulties of its home country, the UK. Weighing on growth are high unemployment, weak, deleveraging consumers, elevated debt levels and painful austerity measures. Despite this dour national backdrop, the British fashion retailer has produced three-year compounded earnings growth of nearly 15% and dividend growth of 18%.[4] How? By expanding in emerging markets, particularly in Asia, where growth is strong and demand for branded luxury goods is rising rapidly as consumers become more affluent. The Asia-Pacific region alone now contributes 33% of Burberry's sales as opposed to 23% only three years ago.[4] And that figure is likely an understatement of the importance of Asian consumers: According to the company, it makes a third of sales in its central London stores to Chinese tourists.

What It Means for Investors

The world is still dealing with the aftermath of the excesses of the first decade of the 21st century and the global financial crisis they helped provoke. Though political and macroeconomic turmoil can make the investment landscape appear grim, smart investors know to look beyond the headlines and focus instead on finding the best-run companies with access to the fastest-growing markets in the world—wherever their headquarters may be.

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1. The mention of specific companies in no way implies that OppenheimerFunds, Inc. invests in them, nor does it constitute a recommendation by any particular funds or by OppenheimerFunds, Inc. As of 6/30/11, Oppenheimer Global Fund had 1.53% of its assets invested in Inditex, 0.57% in Nidec and 1.20% in BBVA. As of 6/30/11, Oppenheimer International Growth Fund had 1.49% of its assets invested in Inditex, 1.56% in Burberry, 0.70% in Luxottica and 1.94% in Nidec.
2. Source of data: UBS Investment Research, 2/28/11.
3. Source of data: Cisco Visual Networking Index: Global Mobile Data Traffic Forecast Update, 2010–2015, 2/1/11.
4. Source of data: Bloomberg, 6/30/11.

Investing in foreign securities entails special risks (such as currency fluctuations and political factors) and may have higher expenses and volatility. Investments in emerging and developing markets may be especially volatile. Investments in securities of growth companies may also be volatile. Diversification does not assure a profit or protect against loss.

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