EMQQ: Interview with Kevin Carter

Charlie Morris:

Welcome ladies and gentlemen thank you to Kevin Carter, who has joined us from EMQQ. Now just to confuse you all, EMQQ is the US dollar ticker, we're using EMQP, which is the GBP London ticker.

It's an emerging market internet story. I had the pleasure of meeting Kevin a few years ago to hear this. It's a fascinating way to look at the world. If you just take an emerging market index, it might be full of state-owned enterprises. Large banks in China for many years, for example, or big and old industrial black-and-white television producers back in the day. But the world's moved on. It has modernised, and Kevin very cleverly put all the internet stocks together from around the world and came up with the concept of EMQQ.

Welcome, Kevin.

Kevin Carter:

Thank you, glad to be here.

Charlie Morris:

So could you just please go back and tell me how you got to EMQQ, where you came from, what is behind the thinking, and how the index is constructed.

Kevin Carter:

Sure, well, long story short, I lived in San Francisco, so I've kind of grown-up in and around the technology progress over the last 50 years. I started, 30 years ago, in downtown San Francisco at what was the leading investment bank at the time for technology companies. So I've been in and around technology for a long time.

I got involved with emerging markets about 20 years ago. I have a long-time business partner, who is a Princeton economist named Burt Malkiel, who some of your friends might know. He wrote a book called A Random Walk Down Wall Street, which basically laid forward the idea of an index fund. Then later he was in charge of the first ETF launched, the SPDR.

So, I have worked with that guy for a long time and he got interested in China. A couple of his Princeton economist friends were Chinese economists, and they had gone back to teach in Beijing around the year 2000 and convinced him that he had to come see what was going on. This incredible growth that was happening. And so, he started going to China and wrote a white paper about China, and then a bunch of our investors looked at me and said, well we want to invest in China. That was 18 years ago last week, and I've been focused on trying to figure out what that even means for almost 20 years now.

Emerging markets have long held a lot of promise; implicit in the word emerging is some kind of growth. The base story is that this is where all the people are. There's 85% of the world's people are already in emerging markets, and they're younger, their economies are growing twice as fast as the developed world, and that's driving what McKinsey calls the biggest growth story in the history of capitalism, which is the rise of the emerging market consumers. So really, from the beginning, what I have been focused on is maximizing the exposure to that consumer growth story. And, as you touched on, trying to get rid of all the problems: the government-owned banks and oil companies that are corrupt and inefficient, and companies like Petrobras, the Brazilian state-owned oil giant that was literally systematically looted for a decade by the last two presidents and a third of the Congress people.

It's been all about the consumer, and I had launched a number of China ETFs with Guggenheim, starting around the year 2007. But when people would call and ask me, what's the best emerging markets ETF, I always told them to just buy the emerging market consumer ETF; the food and clothing companies that would benefit from these 6.5 billion new consumers.

It could have been 10 years ago today, I got a phone call from a friend, and I was in my car and I answered her call on my iPhone, my first iPhone. She asked what was the best emerging markets ETF for a child's College fund and I started to tell her to buy the consumer stocks. Then I had my light bulb moment, if you will, for EMQQ because what I realised was, this device was changing how we consumed. Even 10 years ago, I could see that there was a delivery truck in my front driveway once a week and then twice a week, and then I knew the driver by name. That's how EMQQ came to be.

I didn't see it as clearly then as I do now, but there are three megatrends that are sweeping the planet. I'm part of all of them; you've probably been part of all of them like I have for a couple or even more generations, but most of the world is just getting involved.

Those three megatrends are: First, the rise of all these other consumers. Second, the computer. When I got that call 10 years ago, I had a computer for 20 years before I had a smartphone, but 10 years ago my smartphone was brand new, but most of the world is getting their first computer today. It's not a desktop, and it is not an Apple product; It's an Android-based smartphone.

When they get that first pocket-sized super-computer, they're also getting the internet for the first time. And because they've never had a bank account or a credit card, or any kind of digital payment, they've never had a target store, they don't have an automobile.

They’re leapfrogging and driving what I think is the fastest-growing sector in the world, which is the emerging markets internet sector.

Charlie Morris:

Fabulous. And you mentioned in one of the pieces you wrote about a $14 smartphone in India?

Kevin Carter:

That's true. A $12 smartphone. This is one of the things that makes India exciting. It looks a lot like China did when I got started, but when I got involved, nobody on the planet had a smartphone. Not only can you get a smartphone but now, as you mentioned, you can get one for $12 or $14 brand new. It may not be an Apple iPhone 15, but if you want to make payments or watch videos, it does the job.

Charlie Morris:

I will get back on track, but I just want to mention, I was Uzbekistan two weeks ago, and every taxi I took was on Yandex Go. You couldn't get a taxi without it, and that was pretty eye-opening stuff.

Let's talk about the EMQQ, and don't forget everyone, it's EMQP for us. Let's talk about the index construction. How did you put it together? Is it rules-based or is there an investment committee? Are you thinking about the companies?

Kevin Carter:

Well, it's rules-based, but we certainly put a lot of thought into how the index is put together, certainly more than the average index operation. The reason is every stock company in the world gets put into a database, and so you end up putting these companies in boxes: like what country are you in? And you can only be in one country.

Sometimes, the company will have its headquarters in Singapore for example. All of the major e-commerce companies in Southeast Asia are based in Singapore, so the database sees Singapore and that's a developed country. But the revenue for those companies is coming from Indonesia, and the Philippines, and Vietnam, so that's the first rule. You need to be an emerging markets internet company and we don't care what country your mailbox is in and then we don't care what stock exchange you are on.

Unfortunately, a lot of indexes just look at those things. A Chinese company trading on the NASDAQ won't be included in the Chinese index and things like that. So the first rule is you need to be any emerging markets internet company. Right now, there's about 120 of those. They’ve got to obviously be publicly traded and then, if you are that, no matter what stock exchange you're on or what country you're in, and you meet our liquidity and market cap minimums, we will include you. Then it's a modified market cap weighted which, basically, we cap the largest stock at 8% when we do the rebalance, which is twice a year in June and December.

Charlie Morris:

Okay. It's been an interesting story, and I want to talk about two things. The US-relative valuation, but the other thing, before we get there, obviously with the war in Ukraine there was a stumble, I've mentioned Yandex. What happened there? What countries are excluded? How do you approach listings? For example, if a company's got an American code and a Hong Kong code, what would you choose, and how did you get there?

Kevin Carter:

Sure. Well, in terms of listing venue. We're agnostic in terms of where you're listed we try to buy the stocks wherever they're the cheapest. A lot of exchanges in the emerging markets have a lot higher costs. So buying and selling in in India is a lot more expensive than buying and selling in the United States. So we take that into account. But other than that, we will own you.

In the case of Russia and Yandex, some of your investors may know that when the Russians invaded Ukraine, it became illegal to buy or sell a Russian stock and all the stocks were suspended. We had, I think, six Russian internet companies, a few of which had only been public for a couple of years. These were probably some of the most entrepreneurial and not state-involved businesses in Russia, but, nonetheless, the stocks were halted and essentially all of them were priced at zero so we took a big hit that day. I think Russia was about 3% of our portfolio and all of those stocks went to zero.

Now, interestingly, we still own the stocks, and they show up on the balance sheet, but with a value of zero. In the case of Yandex in particular, I believe that the company is headquartered in the Netherlands, and, as you mentioned, in addition to being the Google of Russia, they're also the Uber of Russia and other nearby countries, as you mentioned Uzbekistan.

But my understanding is they have a cash offer to sell the business, or part of the business, to a group of Russian buyers, I believe $5 billion, so it's possible that we will recoup some of the losses we took from that situation. Emerging markets have a lot of risk: wars and governance of not only companies but countries is certainly a risk in not just emerging markets.

Charlie Morris:

Which kind of brings me to the next question. We’ve seen US tech do extremely well. European tech, well there isn't much of it because the US bought it all or set it all up. And emerging tech; why is it trading at such a discount to the US and, specifically, what's gone wrong with China over the last two years?

Kevin Carter:

Sure, well I think that the simplest answer to your first question is that the valuations are low because of China. And because investors in the US and, I think to a lesser extent, Europe, but certainly the US. They're afraid of China and they're afraid to invest in China. They've seen all these headlines about things that sounded really scary. The two main ones, they've both have gone away but people don't understand they've gone away. But the two big fears that people had were first that the Chinese internet companies trading in the United States were going to be delisted. That was a threat that the US senate had passed a bill to delist these companies because of an accounting agreement that was not in place. Whereby the accounting Watchdog of the United States could go and look at the Audit notes of any company listed in the US. This was definitely a political-election-year-driven thing because that rule has been in place for 20 years and we never enforced it until there was an election. I had a lot of questions about why didn't we enforce this in the first place. We have these rules; why have we not enforced them for 20 years? So that scared people, and you heard it over and over again, delisting. They had a watch list of companies and every time they updated the watch list, even though it was a three-year threat, it was: if you don't do this in three years we might delist your companies. People thought they were going to lose all their money.

It was just silliness and it was resolved. Finally. The accounting Watchdog in the US was part of the problem. The SEC had fired all of the leadership, so it took nine months to replace the accounting Watchdog representatives of our country to engage with China. Once that happened, they cleared that up almost two years ago, but people don't understand that because they saw the headline so many times. So you had that fear.

Then you had this China tech crackdown fear, where the Ant Group Alibaba's fintech IPO was cancelled and you had these anti-trust and monopoly reviews. In every one of those situations, there was four different regulatory things. As I expert in China, I thought this isn't a big deal; I agree with what they did. I thought the Ant Group needed to be regulated more like the bank. And everybody should know that Alibaba and Tencent were very monopolistic as they have a lot of power. So all the things that the Chinese government did that were construed as a crackdown, they're no different than what happens in Europe and in the United States. I mean the people at Google must pay billions of dollars in fines every year in Europe and you see our tech titans in Washington DC.But because people are afraid of China, when they regulate, everyone thinks: oh my gosh, they're trying to steal my money.

So, I think those were the two main things that drove the China stocks down. Again, both of those have been resolved. The crackdown wasn't really an issue except in people's minds. They're definitely regulating their sectors as we do, but they've made it clear that they support private enterprise, and they're not against the internet companies, and that they believe in capitalism. I mean, they should; that's how they got here. So, it's just been a firestorm of negativity. Then you have the US tech trade war. It's created incredibly low valuations for the Chinese internet companies. They could double and they wouldn't be expensive.

Charlie Morris:

Absolutely. I'm going to cover more of that; you put an excellent slide, which I'm going to take and put in the piece that will accompany this video.

You're really bullish on India. You've done some excellent work there. Some fascinating statistics: 2/3 of the people are going to be middle-income by 2030, this sort of thing. The biggest country in the world by population. The sort of tech miracle that we've seen in China with high-speed rail and so forth is coming to India and it's going to be changed and transformed. So, perhaps tell us a little bit about that.

Kevin Carter:

Sure. Well, India is here. It's finally here. Like a lot of people, we've been waiting for India. When we launched 10 years ago in the US, we had 0.5% invested in India and more than 50% in China. That wasn't because we didn't want to invest in India; there were only two public companies, and they weren't that large. Even 3.5 years ago, we were still 1% in India, but finally, and incredibly, right during Covid, from 2020 to 2021, they did 25 IPOs. Not all the leading ones, but many of the 25 of the leading Indian internet companies went public in a 1.5 year period. So, finally, we got meaningful exposure, so it's become a bigger and bigger part of what we do here.

Here's what I say about India. First of all, it is the perfect emerging market, and it can't really happen again. The reason I say that is, if we go back to why invest in emerging markets in the first place, there are four reasons. First of all, they're very very big. They have all the world's people. India is, as you mentioned, now it's the largest population in the world; it passed China a year ago. Today, India set a record as the largest population ever. Tomorrow, it will set a record. And basically, every day for the rest of my life, on that day, India will be the biggest country ever. And. if you leave out China, India is bigger than every other emerging market combined. The second biggest population is 285 million in Indonesia and it won't get to 500 million. India is at 1.5 billion. So it can't really happen again in terms of the scale.

It's young, that's the second reason you want to invest in emerging markets. They have a younger population, and India has twice as many people under the age of 30 as the entire US population. So, it's the biggest, it's the youngest, it's fastest growing. Its estimates are 6.5%, which is twice the developed world's GDP growth, but they've just beat that number ¾ in a row, with a 7%, a 7%, and then an 8.4%. Again, with a 6.5% estimate. So I think the estimates are going to go up; it might be accelerated.

Then, finally, that's driving consumption, and that's the reason we're here in the first place. In emergency markets there are all these new consumers, and when you add the size, the demographics, the growth rate, India is expected to have more consumption than China does in the next 10 or 12 years. 20 years out, significantly more, so if those are the things you're looking for, you're not going to find anything better than this. And it's not even close. Then you add in the fact that the country has probably the most stable democracy on the planet right now. With things like Russia and Putin, governance can be a real risk in emerging markets. Of course, Americans think communism is evil and so we give China low marks in that category. Here you've got the world's largest democracy, and you have this leader who has grabbed the country and dragged it up.

Modi's finishing his 10th year, and he's got the highest approval rating in the world. He's going to get re-elected. The voting just started; it will end in the first week of June. He will get re-elected to a third five-year term. He has basically brought the country from socialism and bureaucracy and he's running it like a company. He's running the whole country like a business and he's cutting out all sorts of red tape and bureaucracy that made it hard for capitalism to flourish. But he's also, perhaps most importantly, doubled the country's infrastructure in his first 10 years, whether it's miles of highways or the number of airports. Everything has been doubled, and he's not done. They've got a 1.5 trillion that will electrify the rest of the rail network. They're building new stations; remodelling stations. They've doubled the miles of highways. They're tripling the number of airports, and they're building the seaports they will need to get products in and out of the country on a boat and that will feed the ability to move manufacturing to China.

So you have this government that's finally running the country like a business. Just as Deng Xiaoping unleashed capitalism in China, Modi is acting in that role in India. But then you layer on top of that two other things. The first is, India has a technology sector that's older than me. You've got these publicly traded technology companies, Infosys, TCS Tata that have publicly traded for 20, 30 years, and they've employed hundreds and hundreds of thousands of technologists. They have an incredible set of technology institutes modelled after MIT. 25 S&P 500 companies have Indian CEOs, including Google and Microsoft. Both of those CEOs were educated at India's best schools, so you're not going to find that in Indonesia or Vietnam or any of those places.

On top of all of this, partially because of the last point, India has a Secret Weapon that people just don't understand and I didn't understand it until two years ago. It's unlike anything on the planet. It's a digital public infrastructure; it's like an operating system for the whole country that cuts out costs and it cuts out corruption. No other country, developed or emerging, has it and it's called the India Stack. But that to me is the cherry on the top of this India story. Part of the reason I'm excited about India, is because nobody knows about this. I talked to hundreds of investors, and 0.1% had any idea about this technology system that India has built for itself. That's really showing incredible power.

Charlie Morris:

There was a story, I'm going to get the numbers wrong, but there were something like a million people or 2 million people who were still being paid by the Indian Railways who were dead; isn't that right? This was one of the things that were reported in this new system and it uncovered all this fraud and inefficiency in the system.

Kevin Carter:

Well, I'm not familiar with that, but that sounds absolutely like something that would happen. The whole country was operating on paper-based files. The entire government was, and parts of it still are, but they've made up a lot of ground on the technology side, and they're all in, in a way that people don't understand. Part of it is, people don't know what digital public infrastructure is when I ask them. What is digital public infrastructure? Do you use any? And no one seems to even know what that means. The internet is the best example of digital public infrastructure, right? It's digital, it's public; everyone can use it, but we don't really see it though. GPS is another example. We're using digital public infrastructure in our own lives, and we can see business models like Uber that really couldn't exist without these things. So not only does India have access to those things, but they've also made their own pieces that, if you stack them all together, it's created this incredibly dynamic and never-before-seen platform of digitisation for all elements of the Indian economy.

Charlie Morris:

Brilliant. Well, Kevin. I'm going to leave it there and just say thank you very much. It's been really interesting. I only wanted to do a short video to bring your ETF that we recommended last week to life for our clients. I think it's a wonderful idea, really makes so much sense that you take the geography and you put the digital on top of it, and then see how that can transform what's underneath the surface.

Well, good luck with everything, and I hope that China internet and India internet come back into favour as they deserve to be.

Kevin Carter:

Thanks, Charlie.