OUTSIDE THE FLAGS

Jim Parker,
Vice President
DFA Australia Limited

Sharing the Wealth: The Case for Equities

MAY 2012

Quiz Question: What do these companies have in common – Whitbread of the United Kingdom, Molson Coors of North America, Qantas of Australia, Honda of Japan and Adidas of Germany?

Yes, they all deliver consumer products and services. Whitbread is in hospitality, Molson-Coors is in brewing, Qantas is in airline transportation, Honda is in automotive products and Adidas is in sportswear.

But that's not all these companies have in common. Have you guessed yet?

Yes, they are all well established and have internationally recognised brand names.

- Whitbread has been around since 1750, when Samuel Whitbread started the first mass production brewery in the UK. The company now employs more than 40,000 people worldwide and serves more than 19,000 customers per month.

- Brewing conglomerate Molson Coors has a history going back to 1774 in England, 1786 in Canada and 1873 in the USA. It now employs 15,000 people, services 30 countries and boasts more than 65 individual brands.

- International airline Qantas was founded in outback Australia in 1920 as 'Queensland and Northern Territorial Aerial Services', operating fragile biplanes. It now employs 35,000 and is one of the most recognised airlines in the world.

- Honda's roots go back to 1937 when a young mechanic named Soichiro Honda started a business making piston rings. Honda is now the seventh largest automaker in the world with 180,000 employees and nearly 500 subsidiaries.

- Adidas, renowned for sports apparel, has a history dating back to the mid-1930s when it was a single, small factory run by a humble shoemaker Adi Dassler. The company now employs 47,000 people and sells its products around the world.

Have you guessed yet? Yes, these are all consumer products companies. They all have long histories and humble beginnings. They all operate internationally. They all employ thousands of staff. And their products are globally recognised.

But that's *still* not all. Give up yet?

The answer is that these companies all operate in the capital markets. They have grown from humble beginnings, partly because they have issued equity and tapped the savings of millions of investors, who in turn have shared in their successes.

It is worth keeping this in mind when you hear grim stories about the future of equity investment and the global economy.

It is true that we have been through and continue to feel the effects of a global financial crisis. This crisis caused strains in the banking system of many developed economies and continues to cause knock-on effects today, particularly in Europe.

But think about this. For all its troubles, the world economy is still growing. The International Monetary Fund estimates global economic growth this year of about 3.5 per cent, accelerating to 4 per cent in 2013. For emerging and developing economies, the growth assumptions are about twice that.[1]

Economic growth means an increase in the world's output of goods and services. This increased productive effort is derived from a number of *inputs* – namely labour, materials, energy, intellectual capital and financial capital.

So at Honda, for instance, researchers might be working on new technology for a zero-carbon emission electric vehicle. To do this, it will hire skilled labour, bring together the raw materials, apply its intellectual capital and raise funds by issuing shares.

As an investor, your role is to supply the final element – the financial capital. In doing so, you take a risk. But you also get to share in the profits of this endeavour.

So, unless you think the people of the world are going to stop buying cars, stop taking holidays, stop eating at restaurants and stop playing sport, it seems foolish to assume that companies' demand for capital will not continue.

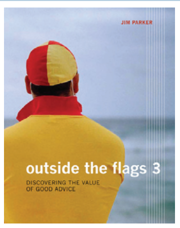
That capital is not free. It *costs* companies to tap the savings of others. And that cost is your expected *return* as an investor. That return is not there every day, every week, every month or even every year. But over time, there is a return on capital for those who are patient and who diversify away risks they don't need to take.

If there was no return, there would be no capitalism. This is not a perfect system by any means. There are questions by some about its efficiency and by others about its equity. But it's the system we have and that most of us work under.

So to no longer participate in the equity market is to deny yourself a share of the wealth that these companies create – companies that provide livelihoods to millions and products to millions more.

Sharing the wealth means owning shares. Quiz over.

1. *World Economic Outlook, International Monetary Fund, April 2012.*



"Outside the Flags" began as a weekly web column on Dimensional Fund Advisors' website in 2006. The articles are designed to help fee-only advisors communicate with their clients about the principles of good investment – working with markets, understanding risk and return, broadly diversifying and focusing on elements within the investor's control – including portfolio structure, fees, taxes and discipline. Jim's flags metaphor has been taken up and recognised by Australia's corporate regulator in its own investor education program.

For more articles, visit Dimensional's client site at https://my.dimensional.com/insight/outside_the_flags/