CREDO WEALTH

Developing developed

Hans Rosling was a Swedish academic and passionate public speaker. He passed away last year, but during his illness, he completed his final book ‘Factfulness’. In it he describes his life’s work of updating perceptions to meet the realities on the ground. He describes our ‘gap instinct’ which explains our tendency to separate things into distinct categories like developing and developed markets. Rich and poor. The reality is that over the last few decades, there has been a dramatic increase in the number of middle income earners. According to ‘Our World in Data’, in 1975 the median income of the developed world was 10 times that of the developing world. The ‘gap’ between developing and developed has been disappearing as poorer countries, especially in South East Asia, have caught up.

The gap in *averages* (which are a summary) does still exist. One such commercial gap is the “mortality protection gap”. This measures the difference between the amount of insurance people carry, and the amount they need to carry to sustain their families. The need is based on age and income levels. As people get wealthier, they have more to protect.

Averages are dangerous. Gaps don’t close in a straight line and averages hide what is happening beneath. This is Rosling’s point. As Howard Marks says, ‘Never forget the six-foot-tall man who drowned crossing the stream that was five feet deep on average.’ The mortality protection gap is closing much faster than it did in the Developed Markets. The number of people with sufficient cover is measured by the penetration rate. The China State Council, McKinsey, Swiss Re and company estimates suggest that China has the potential to match American growth over the 55-year period from 1938 to 1993, over just 15 years from 2015 to 2030. From 2% of people with enough cover, to 7%. The potential addressable market in Asia is huge. Roughly seven times that of the G7 (Canada, France, Germany, Italy, Japan, the United Kingdom and the United States).

This is exciting for companies like the AIA Group, which today has a presence in 18 markets, spanning across South East Asia, where it has been operating since its founding in 1919, in Shanghai. AIA still has a very long runway for growth, particularly in mainland China, where they are underpenetrated and which, in November last year, pledged to open its financial sector to majority foreign ownership.

In Asia, most policies are bundled, offering a combination of savings and protection (e.g. whole life policies). Relative to Asian peers, AIA is more skewed towards protection, which is the faster growing and more profitable segment. Protection products require skilled underwriting which means there is less competition relative to savings products (unit linked, annuities etc.). Unlike investment products, where profits rely on market performance, the profit from protection products is more stable. The money coming in (premiums) and going out (benefits) are matched and offset each other’s underlying investment risk. The stability of profit comes from the skill of accurately forecasting risks, like mortality and disability (underwriting).

We bought AIA in February, attracted by their deep, defendable, underwriting competency. It can leverage this with new technologies which speed up distribution, and loyalty learnings from elsewhere in the world. We have seen Vitality drive market share gains, first with Discovery in South Africa and then Prudential in the UK. AIA Vitality launched in 2015 and is the first comprehensive wellness platform in Asia. This incentivises customers to engage in health and wellness, and provides additional data to further enhance the underwriting capability.

AIA has the ability to do what it does well, for a long time. We bought in at an attractive price, and could be part of the blurring of Developing and Developed.

Important notice