

KHAZANAH MEGATRENDS FORUM 2011



Uncertainty as Normality

Navigating Through
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"Let's make the next 500 years count"

Opening address by YB Tan Sri Nor Mohamed Yakcop at KMF 2011

Drawing from history, current affairs and the wisdom of the venerable Gandalf from "Lord of The Rings", Minister in the Prime Minister's Department, Yang Berhormat Tan Sri Nor Mohamed Yakcop delivered the opening address of the Khazanah Megatrends Forum 2011 and set the tone to two days of fraternal exchange and intellectual introspection on the theme for the year, "Uncertainty as Normality: Navigating through Complex Interconnection."

In an environment where uncertainty is accepted as the normal state of affairs, the shift in emphasis moves from anticipating when an

event will take place—be it a natural catastrophe such as a volcanic eruption or bursting of a market bubble—to the extent and impact of such an event, which in today's interconnected world extends far beyond the physical borders of where the event takes place. Compounded by the immediate and far reaching impact of information transmitted through technology enabled communication platforms, the world is such that "nothing is localised", according to Yang Berhormat Tan Sri.

Abiding by the adage that those who ignore history are bound to repeat it, the speech took as an example the Qing

dynasty in 1500s China, during which an isolationist trade policy and domestic political strife devastated an empire and led to a protracted era of conflict which eventually resulted in China commanding 10% of the world's GDP by 1900, from a previous high of 33%.

Bringing the lessons closer to home, Malaysia can ill afford to miss out on the current Asia-led trajectory of global growth, and must be "the rowers or engines of the boat" in riding the proverbial wave. With the astute observation that the country is celebrating 500 years since Malacca first fell to foreign occupation, it was the following

closing words which captured the prescription for Malaysia, adding another layer to the recent celebrations marking independence and nationhood of so young a country.

"For the next 500 years, we are in a position to manifest our own destiny and our own fate for 100% of the time. Whether we succeed or fail is in our own hands. And I will tell you that there will be a constant stream of uncertainties ahead. How we endogenise these exogenous uncertainties is completely up to us. Let's make the next 500 years count."

Organised by:



Understanding Risk

- Risks are decisions that are made when one has no knowledge of the future, in contrast to uncertainty which is more calculated decision making where some subjective estimate is made on the probability of the future, and ambiguity can create paralysis in decision making.
- By 2014 the growth of debt to GDP ratio for rich countries will reach 120%. Of the debt, there are about USD 200 trillion dollars of instruments circulating worldwide, 2/3 of which are interest bearing.
- Presently, developed countries policy stances seem to be only on creating more and more debts which are not addressing the roots of the problem. The solution of this is risk sharing through coordinated and cooperative policy actions. Risk sharing is important as it helps smooth fluctuations across countries with low connections to growth.

Black Swans/
Butterfly Effect

- A simple financial system is one which is quite predictable with simple rules. A complicated system operates with simple rules but with more elements, while a complex system has an interconnected feedback loop governing it.
- Small changes made in elements of a complex system have a large impact that is the idea of the butterfly effect or black swans. They represent situations where a low probability event has catastrophic impacts on the economy.
- Regime uncertainties cast doubts on market capitalism's survival chances because if left to itself, market capitalism will be unsustainable due to huge income distribution and food inflation issues.

Malaysia and
Islamic Finance

- Malaysia can be a mover of global financial risk sharing through its development of Islamic finance embedded with a risk-sharing concept.
- In reality, the nature of Islamic banking industry is not as efficient presently. It has many elements of market capitalism that are inconsistent to the concept of risk sharing.
- The emphasis is to put in place elements more consistent with Islamic principles such as the utilisation of Zakat (tithes) and changing the definition of Islamic banking to Islamic investment to lead to better application of risk sharing concepts.

Navigating
Uncertainty

- Confusion in the world is due in part to the world looking at its problems with outdated perspectives. The world is in a sea of uncharted waters with compasses that no longer work.
- Upheavals and uncertainties are due to demographics (explosive population growth, ageing in the advanced economies, rising youth unemployment, urbanisation) and instantaneous communication through social media.
- Current analytical tools are inadequate for making sense of the world. The theory, data and analysis of the data has failed us over recent years and the difficulty lies in escaping from old ideas and ways of thinking.

New Frameworks &
Leadership Imperatives

- The world needs to move to think of networks and systems and move out of partial analysis into systems thinking. This will help escape two afflictions: a global mindset problem (failure to consider the whole problem) and collective action trap (indecision and inability to move).
- Contagion risks are now concentrated in three areas: public health, finance and critical infrastructure sectors. Finance creates the biggest damage.
- To deal with the complexities of a sustainable global new order, Asia needs to break out of the gridlock and forge greater cooperation which cannot be top-down.
- The ability to effect change depends primarily on the private sector, especially business leadership. Post-crisis, global institutions at government, business and civil society levels will emerge. Business and NGOs which were previously national will create new institutions that become global.

7 Leadership
Lessons in an Age
of Resource
Constraints

- Promote systems change, foster community and cultivate networks.
- Work at multiple levels of scale.
- Make space for self-organisation by allowing freedom to innovate.
- Seize breakthrough opportunities when they emerge.
- Facilitate but give up the illusion that you can direct change.
- Assume that change is going to take time.
- Most importantly, be prepared to be surprised.

Emerging Markets:
An Attractive
Proposition

- Vast foreign reserves, decreasing debt-to-GDP ratios and an expanding consumer class contribute to the attractiveness of emerging markets.
- From a valuation perspective, emerging market assets remain cheap and attractive.
- Commodities and consumer sectors are recommended as they are buoyed by the expanding middle class.
- In the long run, emerging markets will outperform the world markets due to favorable supply (increase in IPOs 10%-50%) and demand (increase in emerging markets' share of total world market cap).

Investment
Risks

- Risks in investing in emerging markets are: default risk and currency risk, declining export demand from developed countries and money supply risks that lead to high inflation and erode long-run, real values of investment.
- Derivatives continue potential systemic risk, as its size continues to remain huge compared to size of equity and debt markets. Volatility will also remain high.
- From a long-term perspective, there are three major bear markets over the past decade – the Asian financial crisis, Dot.com bubble bust, and the subprime crisis. However, returns have been otherwise high in other period.

Addressing Concerns
In Investing
In Emerging Markets

- A misguided fear of investing in emerging markets is due to misperception of political instability and currency risk as developing countries' currencies have historically depreciated against developed countries' currencies.
- The risk of inflation can be managed by investing on equity investments, as the real returns of strong companies tend to outperform inflation rates.
- Derivatives continue to pose potential systemic risk, as its size continues to remain huge compared to size of equity and debt markets. Volatility will also remain high.

Special Address

Islamic Finance in an Age of Black Swans

Speaker: Dr. Abbas Mirakhor, Professor, Chair of Islamic Finance, International Centre for Education in Islamic Finance (INCEIF)



Luncheon Address

Uncertainty as Normality: Navigating through Complexity

Speaker: YBhg. Tan Sri Andrew Sheng, President, Fung Global Institute & Board Member, Khazanah Nasional Berhad



Special Address

Emerging Markets Outlook

Speaker: Mark Mobius, Executive Chairman, Templeton Emerging Markets Group, Franklin Templeton Investments





SESSION 1
Technology and Innovation ...
The Key to Firm Competitiveness?

Innovation: A Transformative Force

- Innovation is an iterative process that underlines breakthroughs to meet ever changing societal needs in healthcare, transportation, food and communications.
- A dynamic force, innovation is not about just R&D but also about the way we conduct businesses and create value. Key to this is nimbleness and an entrepreneurial spirit to translate basic breakthroughs to technological innovation.
- Manifest in various fields such as software development and biotechnology, innovation is the backbone of competitiveness and an important driver of Asian growth.
- The open innovations system of today comprises the following: focus, leadership and the enabling environment.

Understanding Complexity

- An understanding of complexity is key to remaining competitive. An innovation in the form of complex market trading software increases risks and can lead to disastrous outcomes, such as in the case of the recent UBS rogue trader episode.
- There will come the day when system complexities are pared down, as in the case of DNA sequencing and expression. There will come the day when the DNA of the entire human population can be mapped, for a fee.
- Competition is on a global scale, and technology allows young firms to outdo competitors by deploying new, technology such as social media marketing.

Leadership

- Leadership must rise to the occasion in times of crisis. In the case of the recent Japanese earthquake and nuclear crisis, the government was gridlocked, while local industry recovered relatively fast, illustrating the different degree of responsiveness to crisis.
- Leaders must remain cognizant of their most important asset: people. By creating an environment of creativity and openness, firms can allow their people to find new ways to enhance competitiveness (for example through the use of technology), to the firm's benefit.



SESSION 2
Macroeconomics and Markets ...
The Outlook for 2012?

Global Imbalances Remain

- In the 2008 GFC, monetary policy did not help the real economy and did not help to correct structural imbalances. There is a need to address medium and long term imbalances, through fiscal policy for example.
- The US will drift for quite some time, but the good news is that the global market is not focused on US but Europe instead. The Euro situation is unclear with 3 potential outcomes for Greece: long, slow and contracted economic downturn, partial/orderly default or disorderly default.
- The Eurozone will face a no win situation, while QE3 will not change the consumer household debt problem in the US.

China: The Reluctant Leader

- Beijing will pursue conservative economic policies leading up to the political power transition in 2012.
- China is entering a slowdown and is currently in the second phase of growth stage, with growth slowing but no likely hard landing.
- China's reluctance to be a leader of emerging markets contributes to the multi-polar and multi-speed growth characteristic of the global economic and financial system.

Leadership

- There is a lack of political will to resolve current economic issues, which affects spending decisions by investors. However, this forces politicians to make tough decisions which they have been reluctant to make.
- Credit rating agencies which are private arms should be questioned as to why they operate as quasi-regulatory bodies without any questioning on issues such as the downgrade of the US Treasury which effectively saw S&P regulating without consequences.





"It was a very good first day and the topics were quite weighty. Dr. Abbas and Tan Sri Andrew were almost playing baton with the theme and background between them. We are thankful that we managed to attract many good speakers. It was like piecing previous KMFs together and 2011 is another link stretching the mind intellectually and pushing the limits. Most of the new ideas were liked for its practicality. The newspaper idea this year was very good, along with the download counter.

I think the Prime Minister has set the ground. He's more than willing to understand complex issues and more importantly to act on policies that come with leadership. There must be a will to push these ideas through, otherwise it will merely be academic.

By the way, my favourite team, Tottenham Hotspurs are fourth in the league and closing in on United!"

YBhg. Tan Sri Dato' Azman bin Hj. Mokhtar
Managing Director, Khazanah Nasional Berhad

Testimonials

"Uncertainty as Normality - There couldn't be a more appropriate theme for KMF 2011 than this title, given that the US and Eurozone economic issues are currently creating so much uncertainty in the world. As always Khazanah has selected a panel of excellent speakers and I thoroughly enjoyed the various sessions."

Vaseehar Hassan
Senior Associate, Kets de Vries Institute, London

"Personally, KMF 2011 is a really insightful forum from world class speakers who know their stuff well. Speeches were supported by facts and evidence and excellent analysis."

Jeremy bin Nasrulhaq
Director, Malaysia Airports Holdings Berhad

"The sessions have been very insightful with differing perspectives of the current state of affairs in the economy."

Raja Nazim Nazuddin
VP Group COO's Office, Sime Darby Berhad



When do you believe ASEAN has the best chance to host the FIFA football world cup?

- 1. 2026
- 2. 2030
- 3. 2034

What will Malaysia FIFA ranking be by 2030?

- 1. 20
- 2. 50
- 3. 120

How would the FIFA football world cup impact the Malaysian economy?

- 1. Positively
- 2. Negatively
- 3. Neutral impact

Visit our website at www.kmf.com.my to take the quiz.

Caught on camera!

