

## Alger 's Market Pundit Reflects on World

By JOHN KIMELMAN  
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**AS FRED ALGER MANAGEMENT'S** senior economic analyst, Zachary Karabell gets paid to look at the big picture.

Right now, Karabell, 37, sees a U.S. economy in which companies will continue to be stingy about their hiring and capital spending.

At the same time, he sees vast opportunity in places like China and India.

As the co-manager of the China U.S. Growth Fund, Karabell is bullish on Yum! Brands and Motorola, two U.S. companies that are riding China's boom.

Karabell came to his job through extraordinary circumstances. A PhD in international history from Harvard, Karabell was hired on Sept 12, 2001, the day after a hijacked jet liner crashed into the World Trade Center's north tower, destroying Fred Alger 's offices and killing 35 of its employees. Among the dead was David Alger , the firm's president and resident market strategist.

Robbed of Alger 's talents, the firm needed someone who could think strategically about the economy and markets and write a monthly column about those topics. Karabell, who had built a reputation as an international consultant and published author, seemed like the right fit.

"I have never felt that I was filling David's shoes, only one of his many functions,' he says. "Taking the job felt particularly meaningful. I felt that the best way to honor the firm was to make sure that it survived and thrived."

Recently, he shared some of his thoughts with Barron's Online.

**Barron's Online:** *Since President Bush was reelected, the stock market has had a powerful rally. Do you think that Bush will be better for the markets for the long term than a Kerry administration would have been?*

**Karabell:** I think the markets think Bush will be better. And I think to the degree that people who trade in stocks believe that, [then it becomes a self-fulfilling prophecy.]. Ultimately, it's the fundamentals that are going to drive the stock market. But to the degree that investors feel a little more confident about the universe and that includes who is in Washington, D.C., they are that much more likely to pay serious attention to fundamentals rather than look at them skeptically.

**Q:** *What's clear is that Bush seems intent on trying to privatize a portion of the Social Security system though allowing workers to set up investment accounts. Is this a sensible idea?*

**A:** You know, Chile currently allows its citizens to set up such account with its public pension system And I'm thinking to myself: here we treat ourselves as the paragon of free market capitalism, and we think of Latin America as being sort of behind in that regard. The idea of a small discretionary amount being invested by Americans shouldn't be viewed as being the end of the Social Security system.

<b>Fund Facts</b>	
China U.S. Growth Fund (CHUSX)	
<b>Assets:</b>	\$35 million
<b>Expense Ratio:</b>	2.40%
<b>Load:</b>	0
<b>Yield:</b>	None
<b>Top Ten Holdings</b>	
Top 10 stocks (as of 9/30)	
National-Oilwell	NOI
Shanda Interactive Entertainment Ltd.	SNDA (ADR)
Caterpillar	CAT
Schlumberger	SLB
Axcelis Technologies	ACLS
Schnitzer Steel Industries	SCHN
<b>BOC Hong Kong (Holdings).</b>	-
United Technologies Corp.	UTX
Semiconductor Manufacturing International Corp.	SMI (ADR)
Archer-Daniels-Midland Co.	ADM
<i>Source: Fred Alger Management</i>	

**Q:** You recently wrote that job growth will continue to lag relative to the strong corporate profit growth and economic growth, and companies will continue to reap a larger share of the national income relative to workers. Isn't that a bad development, given the role that consumers play in driving economic growth?

**A:** Well, it's only dangerous if the companies themselves don't spend. Money is money, so whether companies are spending it on labor or something else, as long as it is being spent on something, it's being put to productive use.

**Q:** But don't you need consumers buying things in robust amounts?

**A:** Consumer spending should still go to 4 or 5%, which is high for what they've done historically. Consumers and workers may be gaining less relative to U.S. companies. But just because the rich are getting richer doesn't mean that everyone else isn't also getting richer.

**Q:** Still, there's plenty of evidence that corporations are spending less on hiring and capital equipment than in past recoveries, thanks to both improved productivity and new-found corporate discipline. Is this a temporary phenomenon or a feature that will be with us for a long time?

**A:** This is a secular trend, not a cyclical one. Companies are much more disciplined about new spending following the excesses of the 1990s. And in terms of hiring people, if demand is being met by the current size of the work force, the need for massive new hires just isn't there.

**Q:** I know that in addition to your market strategy role, you also co-manage a China U.S. Growth Fund that purchases Chinese companies as well as U.S. companies that benefit directly from Chinese expansion. Give me an example of a U.S. company that you have bought recently that embodies that trend?

**A:** Yum! Brands, a collection of fast-food restaurant chains, is one of our favorites. [Editor's Note: YUM owns and operates a number of big brands, including KFC, Pizza Hut, Taco Bell, and Long John Silver's.]

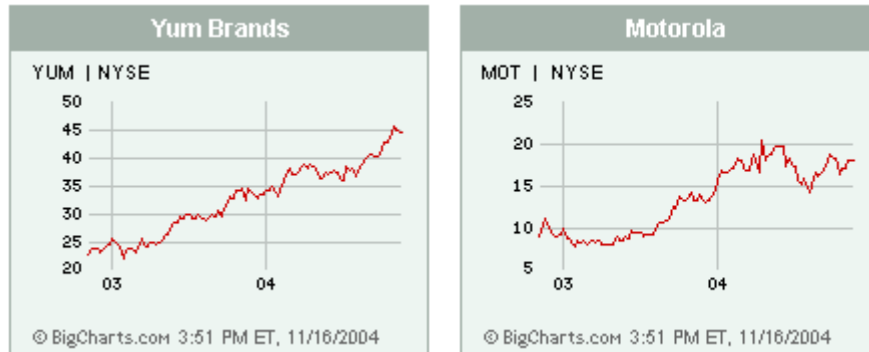
Kentucky Fried Chicken is an incredibly popular brand in China, although there it's just known as KFC. They've taking the same kind of cost model for low-cost fried chicken found in the U.S., but there they've made it into a more of a casual dining experience and they've re-branded themselves in China as a hip place for young people to go. And The Colonel is vaguely Asian, a little bit like if Colonel Sanders and Fu Manchu had a child.

They've re-branded themselves. They use Taiwanese and Chinese managers, unlike MacDonald's in China which brought over U.S. managers so they are much more adept at dealing with the culture of China and so they are able to take some of the same cost space and charge them four times as much equivalently.

They have about 1,200 stores in China, including KFC and Pizza Huts. Though that's two to three percent of their units globally, but because they charge, it represents about 20% of Yum's earnings. They are becoming a much more profitable company by virtue of [their] China presence.

**Q:** *What's another company you like?*

**A:** Motorola. It has staged a nice turnaround. China is the one area of the world where cell phone growth isn't flat. It [currently has] 250 million cell phone users, but it's expected to grow to 500 million in the next five years. And 15 percent of the company's total business is in China. Almost half of that is in cell phones.



**Q:** *You've written that investors are challenged by an environment where change happens more "smoothly," thereby lowering market volatility and making it harder for stocks to generate dramatic movements. Explain to me how this so-called smoothness has come about?*

**A:** Again, it starts with the impact of information technology to give companies the ability to know what's going on, with just-in-time inventory management and the like. A lot of volatility in the past is a product of lack of information or guessing wrong, thinking the demand is going to be much bigger than it turns out, and then being left holding the bag. Or demand could be much stronger than you thought and you would be left with not being able to meet the capacity.

**Q:** *And the implication for investors is that there's just not going to be the kind of sharp movement up and down of stocks as we've seen before?*

**A:** In general, yes.

**Q:** *Thanks*