



HEYÓKHA
BROTHERS



Heri Dono (b. 1960), *The Banter Guards*, 2012, Acrylic on Canvas (125 x 150 cm)

Heri Dono is one of Indonesia's leading contemporary artists. Being the first Indonesian contemporary artist to make it in the global art scene in the 1990s, his works has been exhibited and featured in some of the most prestigious art biennales. His conceptual framework represents his time, and addresses his many concerns, or sometimes even anger, upon his observations on the social, cultural, as well as political situations of Indonesia.

"How much more grievous are the consequences of our anger than the acts which arouse it."

-Marcus Aurelius-

Heyokha's harvest

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What we have learned this quarter

We Hunt the Ghost of Time

Back in 2013, we attended a dinner discussion hosted by the passionate Jakarta-based art collector Wiyu Wahono. The title of event was in line with our naive ambitions: “*How Great Collectors Build Their Art Collections*”. Admittedly since that event not much progress was made in improving our art collection.

We learned from that event that the most successful art collectors - such as Dr. Erich Marx and Eli Broad – have one thing in common: the ability to select art that captures the *Zeitgeist*, or the spirit of the time (in German, zeit: time, geist: ghost, spirit).

We couldn’t help seeing parallels with the investment world, where it is not only the quality of business models (the work of art, if you like) that separates the winning and losing companies, but also the ever shifting mind-set of investors, governments and social institutions alike that could have either a positive or negative feedback loop to fundamentals. Soros calls it reflexivity.

The question is: “*What is the Zeitgeist of the investment world today?*”



Eko Nugroho (b.1977), Brave Because You Are Wrong; Afraid Because You Are Right, 2010 (left); The Fate of a Nation is Determined by Violence, 2008 (right)

Eko Nugroho, Indonesian contemporary rising star, believes that overwhelmed by freedom, people can be lost. He is particularly interested in the social and political setting in art.

The current Zeitgeist: fed up with “unfairness” and current establishment

In order to capture the spirit of the time, a good place to start looking is at places where humanity is expressing themselves, such as in media headlines, art, books, films, social media and more importantly daily observations on the streets.

Headline news...

Just looking back at the past few months, news has been dominated by topics such as the Panama Papers, Brexit and the immigration crisis in Europe.

We also have the rising popularity of sensationalist politicians such as Donald Trump and Duterte, as well as increasing doubts about the strength of world's biggest economies.



Source: BBC.co.uk, Internet

With respect to technology, we see that after the victory of Google's AI AlphaGo over human's cognitive ability in the game of Go, the hype about Big Data has made place for a heated debate about both the threat and potential of artificial intelligence (AI).

While Google is of the opinion that this development bodes well for solving human problems as it can find solutions that humans don't think of, a lot of people are getting scared of the notion that machines are starting to be able to think.

Even Elon Musk is terrified that Larry Page will accidentally create “evil” robots that take over the world.

Superheroes in, Bankers out

In the cinemas these days, it appears that the best Hollywood hits are always the superheroes movies. All kind of combinations are there. Batman vs. Superman? What's next?

The super heroes that fall out of favour are clearly the bankers.

It was not always like this.

In the 80s and 90s, everyone wanted to be a banker. Finance was probably the most popular major.

Even when movies like *Wall Street* (1987) feature cut-throat corporate finance folks like Gordon Gekko, young people back then felt it was really cool to be him and love repeating lines like “greed is good”.



Everyone loved Gekko
Source: Internet

Then in the 90s, Michael Lewis published his now classic book *Liar's Poker*. With his book, Lewis wanted the bright kid who really wanted to be an oceanographer would set out to sea.

Ironically, the message was taken completely differently. Instead, kids read his book as a how-to be a banker manual.

Fast forward to today, while these finance related movies are still screened, they no longer depict these idolised cool characters.

Instead, the message in recent movies make people angry about the dysfunctional financial system and lets them realise that the causes of the 2008 crash are still around.



While the 1% might have read Michael Lewis' *The Big Short*, many of the 99% saw the movie
Source: BBC.co.uk

Even for home screens, HBO is now planning to make a drama series about Bernie Madoff: "*The Wizard of Lies*".

The president of HBO films recently conveyed his vision to the New York Times on the current Zeitgeist: "You can see what's happening in the political process—both parties are dealing with grassroots movements standing up against the shrinking of the middle class and the rise of income inequality...."



Hollywood targeting the 1%?
Source: HBO

"We live in an era of fraud in America. Not just in banking, but in government, education, religion, food, even baseball..."

Steve Carell as Mark Baum in *The Big Short*.

Even the real life Gordon Gekko supports Bernie Sanders

Well, Asher Edelman, on whom the role of Gordon Gekko is partially based, has recently attracted attention for his claim that Bernie Sanders was the only candidate who could save the U.S. economy from a devastating and imminent financial collapse.



Source: Internet

The local street scene: protests by the “victims” of disruption

On the street we were confronted by anger in Jakarta during the recent “taxi” riot (bus and Bajaj motorbike drivers also joined the violent protest).

Taxi drivers were quoted as saying:

"I was forced to stop and join with them [the other drivers]. I cannot do anything because they look angry. It would be dangerous for me, my passenger and my vehicle if I denied their request."

"The government must defend us from illegal drivers (referring to ride-hailing apps such as Uber and Grab) who have stolen our income. We almost cry every day because it's difficult to get passengers."



Taxi riot in Jakarta and around the world
Source: dailymail.co.uk, internet

Of course this is not just an Indonesian phenomenon. Protests against disrupting companies are seen all over the world.

Protestors occupied the Airbnb HQ in San Francisco, driven by anger about increasing rental prices. The same anger drove protestors to block shuttle buses operated by Google in Oakland.

So what is the current Zeitgeist?

In summary, we feel that the many observations like above captures three key *Zeitgeist* currently in motion:

- **Anger:** we believe the cause of the people's anger about unfairness is the unintended consequence of central bank policies that increase the divide between the rich and poor. (Please see Appendix I for further insight on page 11)
- **Disruption:** we believe that the disrupting effects of innovation are accelerating the divide between winner and losers, resulting in increased deflationary pressure leading to more money printing and even bigger wealth divide. (Please see Appendix II for further insight on page 17)
- **Inclusive growth:** we see that some countries are actually pro-actively trying to counter inequality in a manner that is still healthy for overall growth. Examples are Indonesia and - to a certain extent - China. (Please see Appendix III for further insight on page 20)

“One of the great paradoxes of today's innovation: we live in the age of unprecedented innovation, yet at the same time we now live in the age of unprecedented instability. There is unprecedented income inequality. We need more innovation in social practices, we need more innovation in the mind-set of government. We need innovation to make the winners from innovation care more about the losers”

-President Jokowi's speech at the 7th Asian Leadership conference, Seoul, May 2016-

Profit from Anger: gold insurance

“Miss Scarlett Ma'am, I've got to know how much money have you got left? In gold.”

“Look, Mrs. Meade. It's a great deal of money. \$10, \$20, \$30, \$50. And it's not our paper money. It's gold. “

-A dialogue in “Gone with the Wind”-

As for anger, there are many ways to profit. Investors can short disrupted companies but in general, we feel valuations of most of these companies are already low.

As elaborately discussed in the Appendix I page 11, we think that most of the anger originates from widening inequality.

We feel precious metals is the most effective insurance against the consequence of ever widening inequality.

Which growth rate is the outlier?

Average annual growth rates from 2009-2014

Global GDP	2.9%
World population	1.2%
Gold Production	1.6%
Federal Reserve Monetary Base	22.5%

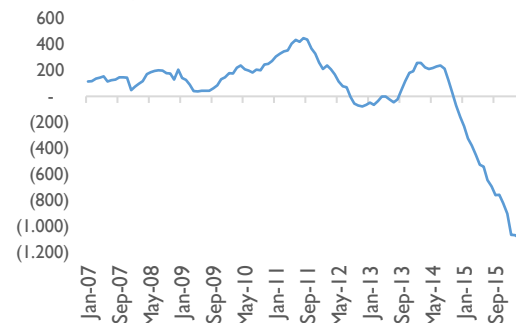
Source: The new case for gold, James Rickard

While the guy with the 9 to 5 job might not go stock up some gold, the top 1% would be much more open minded about gold than the average person.

This is especially true with common report standard coming into effect soon, the Panama Papers and the clamp down on capital outflows by the Chinese government. The world's top 1% and the wealthy Chinese will increasingly look for foreign currency to buy (in addition to soccer teams, of course).

China capital flows

12-month rolling sum in US\$ billion



Source: Bloomberg

We believe gold will increasingly become an important destination for currency diversification. Gold is the one asset with no counter-party risk (that's why it carries no yield) and much more difficult for governments to manipulate.

In fact, the recent surge in the holdings of gold ETFs suggests that the 1% is already in the process of accumulating gold.

Total Gold Holding by ETF

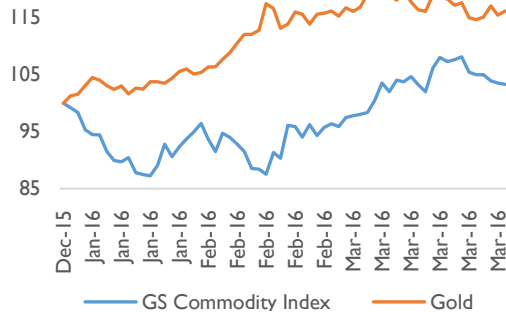
In million oz.



Source: Bloomberg, Chris Wood

Gold vs. Goldman commodity index

In index



Gold decoupled from other commodities in Jan-Feb 2016 when it looked like a financial crisis was brewing

Source: Bloomberg, Heyokha

Didn't John Maynard Keynes say that Gold is a "Barbarous Relic"?

"Keynes never said it. What he did say was more interesting. In his book Monetary Reform (1924), Keynes wrote, "In truth, the gold standard is already a barbarous relic." Keynes was not discussing gold but rather a gold standard, and in the 1924 context he was right. Keynes was above all a pragmatist.

In July 1944, near the end of his life, Keynes argued at Bretton Woods for a new form of world money he called the bancor, the theoretical predecessor to today's SDR. The bancor would be backed by a commodity basket including gold. It was not a strict standard. Still, it did give gold an important place in the monetary system."

-The New Case for Gold, James Rickards-

Profit from Disruption: be selective

Of the three key themes we discussed earlier, the most obvious way to benefit from disruption would be to invest in the disruptive companies.

Whilst we like many of the innovative technology companies that we have met, we need to be very selective. We feel that there is simply too much money chasing too few viable unicorns, driving up valuations to such levels that there seems to be little or no upside left.

Also, seeing so many of these Tech "experts" giving seminars on how to play in this new digital era, we are naturally cautious. We feel that the risk/reward is just not on our side.



The title for this seminar is simply outrageous

Source: Heyokha

Profit from inclusive growth: Indonesian Zeitgeist benefactors with moat

The main theme here is that Indonesia has a President that forcefully deals with inequality by way of inclusive growth (See Appendix III page 20)

Given the enthusiasm about Jokowi's policies, investors have been stumbling over each other in seeking exposure to Jokowi-theme names or sectors.

Yet, in a small financial market like Indonesia, a popular investment space can quickly become crowded. Construction names, for example, have been very popular with multiples expanding from single digit to low 20s where risks are ignored.

Heyokha spirit means that we prefer something less crowded. So, one's portfolio should consist of stocks that play the *Zeitgeist*, but not yet fully reflected in the valuation.

As discussed in detail (see Appendix III page 20), we think that Indonesian companies having a strong presence in the grassroots area are in a good position to benefit from the current *Zeitgeist*.

However, tailwind from *Zeitgeist* is not enough to make a good investment. We are looking for companies that have what Warren Buffet calls "moat": a barrier that protects a firm and its profits from competing firms. Or in other words: sustainable competitive advantages.

"In business, I look for economic castles protected by unbreachable 'moats'."

- Warren Buffet -

There are four Indonesian companies we want to particularly highlight as we feel they enjoy tailwinds and have substantial moat: the bread maker, the seed maker, the drug maker, and the biscuit maker.

The bread maker

While we were travelling to the rural areas, we noticed a bread maker whose products are the most sought after items in the new Alfamart (AMRT IJ) stores in the villages.



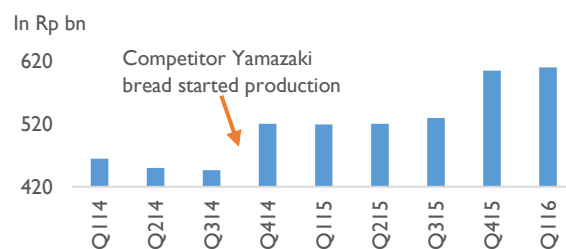
Bread, affordable luxuries in a new Alfamart shop in a village in Karawang, West Java. Alfamart customers are required to clean up the mud from their feet before entering the store.

Source: Heyokha

The following are the reasons why this leading bread maker is a good way to play the grassroots consumption theme:

- Solid brand and capital intensive nature of the business set high barriers to entry. Numerous new players such as a JV between Yamazaki Japan and Alfamart have tried to make an inroad but our bread maker's sales were totally unaffected.

Our bread maker sales



Source: Company data

Given the short shelf life of bread, distributors prefer to carry products with a strong brand. New entrants will also suffer from high entrance cost since many products will, at least initially, expire and be returned.

We learn from some reputable retailers that in dealing with our bread maker, one should expect to get only 50-70% of the orders filled, due to high demand for their products.

- Call option on the general trade. There is potentially big upside if the company manage to penetrate the general trade channel. Our bread maker currently supplies only around 30k warungs (general neighbourhood stores), while Unilever supplies about 1mn warungs. Assuming the company could penetrate 500k warungs, this would lift their revenues to four times as much as 2015 revenue.
- Further room for expansion outside Java. As only 13% sales of sales is generated in plants outside Java, there is still ample room for further penetration of the other Indonesian islands.

Thanks to the company's strong free cash flow generation, we expect expansion can be funded internally while retaining a healthy balance sheet.

The seed maker

An Indonesian seed maker that we mentioned in our previous reports has strong competitive advantages that allow them to command 50% plus market share in national corn seed market.



Click link [here](#) for our 4Q 2015 report

We can summarise their moat as follows:

- Unmatched sales team and distribution network. We witnessed that the sales team in East and West Java had fostered a very close relationship with the farmers and government officials.

As the companies' salespersons typically come from the same region, they are generally being perceived by the farmers as "one of their own".

Sometimes the local approach doesn't work due to "no prophet is accepted in his hometown" phenomena, but this is the exception rather than the rule.

In contrast, their multinational competitors rigidly insist to hire overseas graduates. Yet these

graduates are not able to connect effectively with the farmers due to their inability to speak their local "language" and understand their culture.

In some cases, these multinational competitors send female salespersons to see farmers. This approach worked for a while until the farmers' wives (who usually also come to the farm) hinted at their unhappiness with their husbands dealing with a female salesperson in a conservative rural Java backdrop.

- Strong relationships with various governmental bodies allows the company to participate in the seed subsidy program. Participation in this program is important not only for the immediate impact to earnings, but also for the opportunity to introduce their hybrid varieties to farmers.



Seed company outdoor advertising, rural style (top left), army personnel making sure no funny business going on (top right), even dogs are happy in rural Java (bottom left), good harvest in East Java (bottom right)

Source: Heyokha

- Largest seed research and development facilities in Indonesia, enable the company to produce seeds that suit local soil and climate. In contrast, other seed companies only have research facilities in Java. Our preferred seed company controls about 90% market in Sulawesi and this could happen because

they have a research facility there. Non-Java market contributes around 50% of their sales.

- Soon to be released hybrid rice seed has a huge potential upside since the rice seed market is six times larger than the corn seed market. Our preferred seed company is in a good position to be the first maker of commercially successful local hybrid rice seeds. They have spent many years and allocate a lot of resources to improve their hybrid rice seed product.
- Strong balance sheet, net cash position, increasingly important in an environment where it is getting clearer that the central banks globally fail to stimulate the economy.

The biscuit and coffee maker

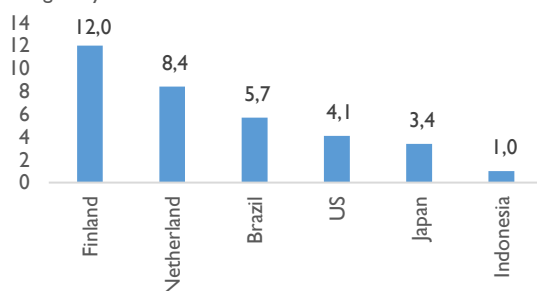
Our biscuit and coffee maker is the contender of the first truly multinational out of Indonesia, generating almost half of its revenues from outside of Indonesia.

Even with such an achievement, we also witnessed during our trip how the company is relentlessly fighting for its market shares domestically, store to store, warung to warung.

Tea, biscuits, and cigarettes seem to be the absolute items to have on the table for a civilised conversation in the village.

Coffee consumption per capita

In kilogram/year



**Finland has the highest per capita coffee consumption in the world: 12kg/person/year. Maybe there is a relationship to coffee drinking and the Finnish being one of the happiest people in the world!*

Source: International Coffee Organisation

Coffee is increasingly making its way, replacing tea in this predominantly tea drinking nation. The

upside for coffee consumption in Indonesia is enormous.

Despite the fact that Indonesia is the fourth largest coffee producer in the world, coffee per capita consumption is merely 1kg per person per year.

We believe that this company has moats that are very difficult to breach:

- Well diversified product portfolio & strong R&D capabilities - management has proven able to formulate a product that is widely accepted by most of people's sense of taste at affordable prices, thanks to a strong commitment to R&D.

The company's founder and family members are still very much involved in product testing, indicating their relentless attempts to keep on innovating. Commitment to research explains their success inside and outside of Indonesia.

The company's product portfolio is well diversified. Multiple products in the portfolio allows the company to use different set of weapons to fight a different war in the country's ruthless consumer market. Many of their competitors admire this company's persistent innovation.

- Strong in export market, first truly international brand from Indonesia? This company has the chance to become the first company to turn an Indonesian brand into a global brand since they have a very strong footprint in the export market. The company is now a big player in Chinese biscuit market and is expanding further internationally.
- Plenty of room for improvement both in general trade and export market - the company is shifting towards the general trade channel in order to maintain their aggregate bargaining power. By doing so they have successfully reduced collection days from 40-50 days to 32 days.

Yet, we understand that market penetration rates are still low in the general trade market, especially in ex-Java area. We see this as another potential upside, aside from a continued expansion of the export market.

- Management depth, hunger for success. Unlike what we observe at many other Indonesian consumer companies, the company's management does not depend on just one person. This reduces risks to performance stability in the long term.



Moreover, the management team has the reputation for being very hard-working and humble. The old school recipe for success.

Enjoy reading our reports? Check out our [website](#) for more!

-The End-

----- Appendix I -----

Zeitgeist #1 Anger

Failing Central Bankers are driving inequality wider and wider



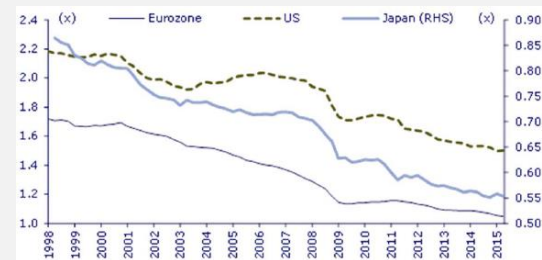
Click the [link](#) here for the report.

In our quarterly report of 3Q 2015 (“*Apes Speak no Evil*”), we conveyed our view that global central banks are finding themselves in a trap of their own making. Fourteen trillions USD equivalent (probably significantly more today) have been printed since the end of the GFC.

Not only did the global economy not deleverage since the 2008 crash, instead it even doubled down on more debt. And yet we getting deflation instead of inflation.

US, Japan, and Eurozone money velocity

In nominal GDP/M2



Source: CLSA, CEIC

Despite all the money printed out of thin air, money velocity is decelerating. Why is that?

While there are many possible explanations, we believe one key reason, where many fail to discuss, is the fact that the current growth model might be nearing its limit – money printing, leverage and extreme policies such as NIRP assume they are able to extend the old growth model.

It is clear that every dollar of debt simply does not produce the same effect on growth as before for the following reasons:

- The old model is very much challenged by demography and urbanisation (both contributed to rising productivity) trends that turned unfavourable in developed countries, and recently even in some developing countries.
- In addition, the old model is also confronted by stagnating household income and the fact that private money is diverted to finance budget deficits.
- Perhaps NIRP and debt are designed to stimulate demand that might not actually exist.

Depopulation and reverse urbanisation

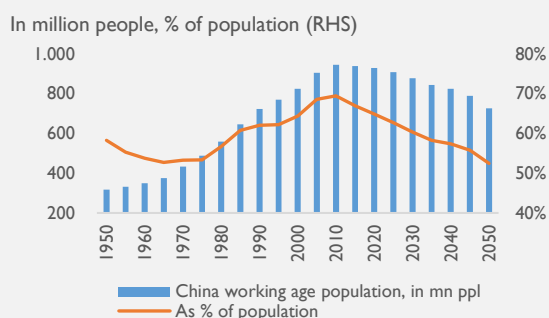
With regards to demography and urbanisation as the source of rising productivity, it is worth paying attention to the big picture thinker and historian Gregory Copley.

Depopulation:

Copley pointed out that until recently, population decline was mainly the domain of developed countries. The thing is that it is starting to bite even harder in developing countries.

Case in point is China, where the working-age population shrank for the first time since the UN began keeping records in 1950.

China working age population



Source: United Nation Population Division

Growth in the productive age segment of the population has plummeted from about 2% before 2005 to only about 1% currently.

An extreme example of demographic challenge is Japan. Shigeru Ishiba, the minister in charge of overcoming population decline and vitalising the local economy, recently stated that Japan's population will decline to 3,000 people by the year 3000! It may hit zero afterwards, if no measures are taken.

With regard to immigration as a cure for the depopulation issue, Copley takes a view that it will take two generations for the refugees to be assimilated.

Reverse urbanisation:

Copley holds the view that mega cities represent a seismic break for civilisations—an apex of multiple, corrosive vulnerabilities.

Again, China is a working example of the reversing trend here. China's migrant population fell by 5.68 million in 2015—the first annual decline in the migrant worker population in at least three decades.

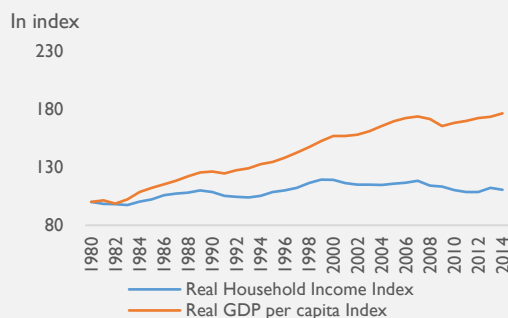
This is a significant milestone that economists call the Lewis Turning Point. With labor shortages in the big cities, corporate profits and asset prices may fall.

Stagnating income and less money available for the private sector

Stagnating income:

The chart below on US real median household income is one possible explanation for Trump phenomena. According to research by Edward Wolff from New York University, median net worth has declined massively, down 85% from 1983 to 2013 for the bottom income quintile, down 63% for the second lowest, and down 26% for the third/middle quintile.

Real household income vs. GDP per capita



Source: Bloomberg

GDP per capita is growing, while medium income is stagnating. This indicates that the average household is not benefitting from this increased productivity and we see this as an additional pressure on income inequality going forward.



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Less money available for the private sector:

It is interesting to note the opinion of investment strategist Russell Napier that from 1996 to the peak of the central bank's ownership of US Treasury in 2013, the central bank market activity freed up about on average US\$ 311bn per annum for consumption or for the financing of private sector activity.

This means that going forward, without central banks' intervention, the more US saving pools are redirected to fund the US budget deficit. The implication is that there will be higher savings (less consumption) and /or less money available for the private sector.

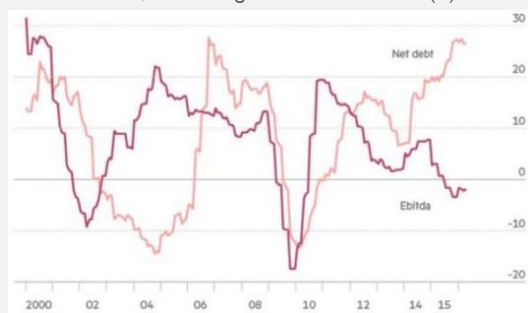
Stimulating demand that might not exist?

While central bankers believe there's plenty of demand to stimulate, certainly corporates don't feel the same way.

Stan Druckenmiller has efficiently pointed out how US central bank policy has led to 'reckless' and 'unproductive' behaviour by corporates. The two charts below speak all.

The peak in profits is past

US non-financials, YoY change in net debt & OCF (%)

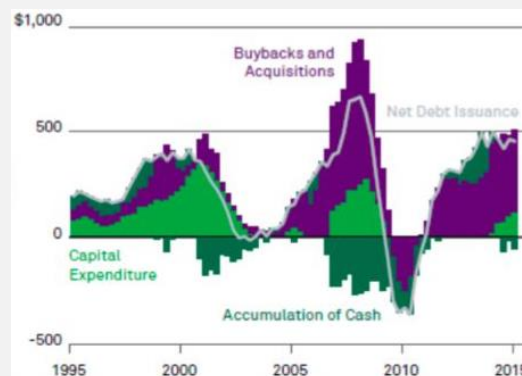


Source: Societe Generale

The graph above indicates that US corporate debt continued to increase for the past 5 years. While this seems to indicate that the CB policy is working (in a sense companies are actually borrowing!), it is important to note that debt has been increasing while earnings have been going down at the same time.

US non-financials firms use of debt

In US\$ billion



Source: BlackRock Investment Institute, Federal Reserve, IMF

Graphs above shows increases in debt were used primarily for capex in the 90's (see green surface of the graph), now most US debt is not being used for investments in productive assets, but for financial engineering purposes, such as M&A activities or share buy backs to manage EPS.

This 5-year divergence between growing debt and decreasing earnings is unprecedented in financial history.

We do not know the exact reason why companies are not spending on capex (maybe companies are not confident that there is sustainable demand; do you think incumbents like JC Penney, Sears, or Caterpillar will be motivated to spend money on capex?). What is clear is that corporates prefer to be creative in managing their EPS.

Anger: Asset price inflation is favouring the rich

As we discussed earlier, we believe that the old growth model is already nearing its limit.

However, our current belief is that we must grow in order to survive (corporatism 101). Growth has also become part of the DNA of the central bankers.



Like other things in life, coral reefs and jungles eventually stop growing, but doesn't mean they are dead. They have simply reached a certain level of maturity. We believe that our old growth model too, is approaching its limit.

Source: Bobobobo

Thus, the central bankers will be forced to do more extreme forms of money printing to keep the economy growing and to combat deflationary forces. The fusion of monetary and fiscal policy is probably upon us.

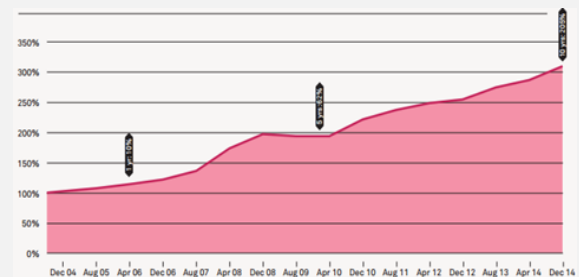
In his recent statement, Japanese PM Shinzo Abe has invoked the word "crisis" to try to get what he wants, i.e. a global "fiscal mobilisation".

Is Japan on the verge of launching the direct financing of the state by the central bank/helicopter money?

Hard to imagine the wealth divide reversing under such a scenario.

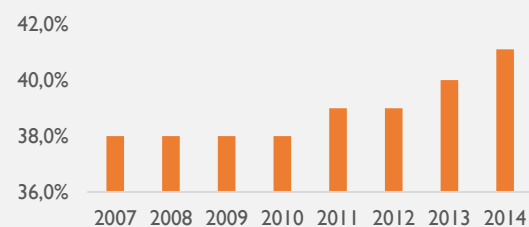
If increasing the velocity of money is what Central Banks are after, they are bringing money to the wrong people. When the top 1% are getting money, they would spend only a very small part what they earn. Yet, when the lower end of the economy is getting money, they might spend 100% or even more of what they earn.

Knight Frank Luxury Investment Index



Source: World Bank

US Gini Coefficient Index



Source: World Bank

* US Gini coefficient index is ticking up since the GFC (above); Knight Frank's Luxury Investment Index (KFLII) tracks selected collectable asset classes - such as art, classic cars and wine, items collected by the wealthy. So much liquidity is pushing all collectibles prices up.

As quantitative easing is transferring wealth and income to the top, the consumer base is basically shrinking, which is decreasing the velocity of money.

The 1% is getting richer but not necessarily spending more to buy that extra TV or pair of jeans.

INSIDE OUT AND COLLECTIVE ANGER

In dealing with the subject of sadness and anger, Heyokha team can't help but think of Pixar's award winning movie *Inside Out* (2015), which really shows how emotions are running things in a human's life.

Scene from "*Inside Out*" when Anger took control of Emotions Control Panel inside Riley's head.



Source: Youtube

The story takes place mostly inside the mind of an 11 year old girl, Riley, where five emotions are represented by characters with equivalent names: sadness, joy, fear, disgust, and anger.

The way Pixar portrays the five emotions are so creative that we were experiencing an emotional rollercoaster while watching the movie.

Anger researcher Ryan Martin blogged on Psychology Today that Pixar "really got anger right". He says that although Anger is usually shown as aggressive in the movie, there's also clear acknowledgement at a couple of points that anger is important and even useful.

Anger is shown motivating Riley on the hockey rink, and the Anger character's introduction at the beginning of the movie describes anger has making sure things are fair.

Anger, for lack of a better word, is good.

We found that the connection between anger and fairness is cited frequently. In the "*The Science of Inside Out*" by Ekman & Keltner, they mention studies that find that when we are angry we are acutely attuned to what is unfair, which helps animate actions that remedy injustice.

Other studies also find that it is anger (more so than a sense of political identity) that moves social collectives to protest and remedy injustice.

However, it turns out that anger alone is not the only prerequisite for people to take a protest to the streets. In a paper published by Journal of Personality and Social Psychology, Zomer et al. (2004) explained collective action based on group anger and group efficacy.

The key finding is that when groups are disadvantaged, group members must perceive that their disadvantages are collective in nature, in order to do something about it. Unfair or illegitimate collective disadvantages promote collective action.

Admittedly, in Jakarta some people need no anger, nor perception of collective disadvantage to take it to the streets.

The demo/protest industry is a serious business in Jakarta, especially in the post-Suharto years. Hired protesters can expect to receive some little cash plus a lunch box. A pack of cigarettes is always a well-appreciated incentive.

Paid protesters are usually much less militant in nature. They will disperse by themselves facing the simplest adversity such as denying them access to deep fried banana sellers.

Having said all this, we would caution against assuming all the protests in Jakarta are staged with a message that is lost in translation. Some anger is real and in the current digital age of social media and web blogs, the notion of anger can spread like fire.

While it was fun to watch Anger in Inside out, it is certainly not fun living in world where anger increasingly take control of the emotion control panel.

Anger that is driven by the notion of unfairness and addressed the income inequality across the globe.

The side effects of all these worries, fear and notion of unfairness is the rise of politicians who promise “simple,” in many cases one liner solutions such as Donald Trump, Bernie Sanders and Duterte.

We feel that their popularity stems from a widespread belief – fuelled by income inequality, corruption cases and disclosures such as the Panama papers - that the establishment is uninterested in ordinary people and that a better future is no longer in reach for those who work hard and play by the rules.

As such, the people want to break from the past and do-away with the elite that they think is out of touch.

In a society where there is anger about injustice, impunity, plunder, and inequality, citizens might make awful choices in leadership. Many are worried about where the Philippines and the US are headed.



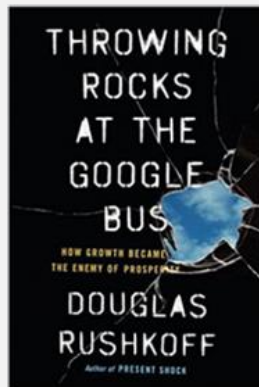
"Yes, it's a stupid speech,
Senator, but you've got
to court the stupid vote."

Source: Jantoo

----- Appendix II -----

Zeitgeist #2 Disruption

Technological disruption drives winner-takes-all effect



Earlier we discussed our real-life experience with the anger of taxi drivers towards the digital ride sharing app companies. This led us to read the book *Throwing Rocks at the Google Bus*, written by Douglas Rushkoff, a professor of Media Theory and Digital Economics at CUNY/Queens.

The core problem of this digital age, according to Rushkoff, is that the current state of play in funding, running, and exiting digital companies is unsustainable.

His argument is that due to the short-term, growth-addicted mind-set of investors, companies are pre-programmed to drive for market dominance, value extraction and profit maximisation, no matter what the human cost.

While this is nothing new in itself, he claims that the digital revolution serves as a catalyst of these destructive impulses.



Not exactly throwing rocks at anything, but Grab, Gojek, and Uber in Bali trigger protest too in Bali.

Source: Heyokha

Tyranny of choice: the winner takes all

Rushkoff explains that the digital selling platforms are exacerbating the extremes between superstars and those who sell nothing.

The reason for this is that the overwhelming variety of products offered by these platforms cause humans to rely more on inferences from what earlier people have done. Think of numerical ratings, online reviews, and top sellers lists.

These recommendations lead to increased sales for certain products, resulting in a positive feedback loop, instantaneously reinforcing itself and skewing sales results to the more popular products.

What contributes to the internet's winner-takes-all effect is that these platforms are highly centralised: iTunes sells the music, Netflix sells the movies, and Amazon sells the books (and almost everything else).

The whole process is creating giant digital stores where the many purchase items from the few. We are all buying from increasingly fewer places and people, putting incumbents out of business along the way. This force is driving the creation of monopolistic companies and is exacerbating wealth disparity.

We should note that not everybody shares Rushkoff's view. Proponents of the "long-tail" idea predict a shift in consumption away from a relatively small number of "hits" to a much larger number of lower-selling niche products.

Whoever is right, in both views there is room for the emergence of several successful digital platforms that centralise influence in certain industries. Money will be flowing through these new organisations, and towards fewer people than ever, not more.

While millionaires and billionaires are being minted in the digital industry, this may not be enough to compensate for the millions of people displaced from their jobs or disconnected.

Automation to take over more jobs and skew gains to a few

The discussions about Artificial Intelligence ("AI") have heated up after the Google-developed AI AlphaGo beat the legendary Korean Go player Lee Sedol.

Computers have already been beating humans at games for years. But Go – arguably the most complex board game mankind has devised – remained a stronghold of human mental superiority.

Google is of the opinion that this development bodes well for solving human problems –of course– as it could find solutions that humans don't think of. Imagine the diseases we might be able to cure...

Yet, a lot of people are getting scared and they might have a point.

While certain economists claim that innovation is also creating jobs, there is an increasing support for the idea that technology is now becoming so advanced that long term loss of jobs is inevitable without further interventions.

While we believe that wide spread human replacement by robots across all industries is still many years away, we do feel that certain industries will be impacted sooner. We see this as an additional pressure on income inequality going forward.



Mark Zuckerberg and Imperial Ambitions, The Economist, Apr 2016
Source: Heyokha

"It's the great paradox of our era. Productivity is at record levels, innovation has never been faster, and yet at the same time, we have a falling median income and we have fewer jobs. People are falling behind because technology is advancing so fast and our skills and organisations aren't keeping up."

- Eric Brynjolfsson and Andrew McAfee from MIT -

Bottom line: deflationary pressure in the short term is adding stress to the financial system

Adding stress to the current system is the ability of the digital disruptors to monopolise entire sectors through a single platform.

As discussed previously, these tech leaders are driving unprecedented industry consolidation.

While the winner-takes-all nature of tech disruption's end game is hardly deflationary, the reality is such that at least the initial stages of the disruption is deflationary.

Armed with venture capital and private equity funding, tech start-ups initially drive the prices down to deliver growth hacking.

Moreover, since growth is the core of the digital economy, tech disruptors will also initially pass on all the tech-driven efficiency gain to grab market shares. This process will likely force the disrupted incumbents to slash prices to protect their market shares.

One fine example of this deflationary process in play is how Uber-Grab combo has managed to force Indonesian premium taxi company Bluebird to lower its tariff.

Recently, Bluebird has lowered their min taxi pre-order charge by 50% from Rp40k to Rp20k, ahead of the ~7% fuel price reduction. This taxi company, an icon of great service in many big cities of Indonesia, also lowered the tariff by 15%.

----- Appendix III -----

Zeitgeist #3 Indonesia: seeking growth, but inclusive of the grassroots

"Masela is incredibly important. If I am there, my people say to me: make sure that the gas is processed on land in factories where we can work. Are revenues higher for the companies if they process the gas at sea? Yes, that's right. But pure profit is less important to me than making sure the residents benefit."

"That's what my people want"

- President Jokowi repeats it at least ten times during the interview the mainstream Dutch newspaper NRC Handelsblad-

In our opinion, the *Zeitgeist* in Indonesia is consistent with what we observe elsewhere in the world, i.e. the issue of 1% and 99%, the sharp wealth divide.

With a Gini coefficient of 0.41 by the end of 2015, President Jokowi has warned that if left unchecked, the wealth divide could threaten the ability of Indonesia to maintain its social harmony and move forward.

It is important to note that Jokowi, with no ties to the elite in Jakarta, wants to deal with this issue. **FORCEFULLY.**

And it's not just talk. Jokowi's support for the grassroots can be seen from his policies that are dominated by massive investments in infrastructure, agricultural reforms and social programs such as subsidies for housing and mortgages as well as free healthcare and education for the poor.

"It is good for a market economy to have income inequality but to extremes, it can actually damage growth long term and make it less sustainable."

- Beth Ann Bovino, Chief of Economist S&P -

See table on the next page for a selection of programs in support of the grassroots.



This is as grassroots as it can get
Source: Kompas

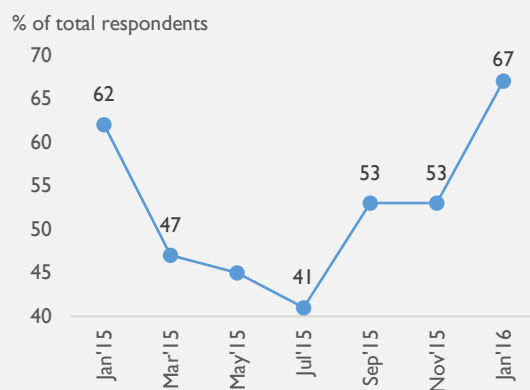
Government programs to support grassroots	Comment
Agriculture related	
1) Village funds	Bigger allocation, better execution
2) Seed subsidy	Better seed quality, better execution
3) Free agriculture equipment	Bigger allocation, better execution
4) Fertilizer subsidy	Better execution
5) Increase in floor price for corn/rice	More crops covered and better execution
6) Rice/corn import ban leads to higher crop price	No import restriction previously
7) Dams and irrigation development	Bigger allocation, better execution
8) Bulog rejuvenation & expand its role to absorb more type of crops	This is new
9) Insurance for crops failure and fisherman	This is new
10) Reduce the food price volatility by cutting the middlemen	This is new
12) Protect local fisherman by sinking any foreign flag fishing boat in Indonesian sea	This is new
Others	
13) KUR (Subsidized micro loan)	Much lower interest rate
14) Tapera (Housing Funds)	Collective funding for low end housing
15) Rumah MBR (Subsidized housing) and FLPP (Subsidized mortgage)	Only eligible for low income people
16) Jamkesmas (Universal Healthcare by BPJS)	Collective funding for healthcare program
17) Social security and pension (BPJS Ketenagakerjaan)	Collective funding for social security and pension
18) Increase in non-taxable income twice since JKW came to power	Non-taxable income has doubled within less than 2 years
19) Tax amnesty to fund infrastructure and Universal healthcare	More tax collection to fund the grassroots program
20) Spending spree in infrastructure	Provide more jobs for blue collar workers
21) Indonesia smart and health card	Free education and healthcare for poor people

Source: Heyokha

It's important to note that Jokowi is not afraid to take unpopular decisions as well (a fact conveniently ignored by those who have been attacking President Jokowi as a pure populist), such as ending the fuel subsidy program.

Obviously, this decision impacted his popularity initially. But Jokowi's approval rating has rebounded recently, as Indonesians start to digest his policies.

Jokowi approval rating, 2015 – Mar'16



Source: SMRC

Survey on Indonesia country direction



Source: SMRC

President Jokowi has made it crystal clear what he wants. He wants his people to benefit from the country's economic growth. He wants a better life for the common Indonesians, wealth distribution in addition to wealth creation. An inclusive growth.

"With this decision (ending fuel subsidy), I now have room in the budget to build roads, to build railroads. I can subsidise better engines for fishermen so that they can catch more fish. I can give farmers money to buy better seed. "

- President Jokowi -

With a president thinking about engines for fisherman and seeds for farmers, we are very positive about a recovery of Indonesia's grassroots. In fact we observe this is already playing out. We will elaborate on this below.

Presidential visit reconfirms agriculture is high on the agenda

A particular event that we believe worth highlighting is President Jokowi's recent visit and meeting with farmers in Brebes, Central Java.

At this event Jokowi launched the "Synergised-Actions for the People's Economy" program, aimed to solve issues that farmers are facing, such as problems with access to finance, with supply of quality seeds, with land certification, etc.



Will it be like Soeharto era where the president himself talk regularly with the farmers?

Source: Kompas

A lot of hype was surrounding the event, for sure. However, in our view, this event is historically important for the following reasons:

1. Marks the end of farmer negligence: the president who is visiting the farmers outside election time together with some heavy hitters such as the central bank governor and head of OJK is a confirmation that agriculture is considered important by the current government.



The President brought his ministries and high-ranking officials to get their feet dirty
Source: Kontan

This is a symbolic end of the negligence of farming and farmers that was prevalent ever after the Suharto era.

2. Stimulating interest in farming?: we feel Jokowi's visit might help to stimulate interest in farming, which is important as a survey indicated that 90% of respondents aged between 15-29 years living in the rice producing areas object to become farmers.

3. Driving innovation - Jokowi supports to improve farmers life through digital innovation by promoting start-ups active in the agricultural sector.

At the event the President “launched” mobile apps that would help farmers to digitise their interaction with consumers or give farmers easier access to information about crops, prices, farming equipment and counselling.

The increased information about prices should give farmers a better negotiating power with traders. We do note however that adoption by farmers might be limited, as the vast majority of the farmers that we met during our trip to rural Java do not even use a smartphone.

4. Led Jokowi to promise better seeds – after farmers in Brebes showed the President a bag full of pest-infected shallot seeds (part of free seed program), Jokowi promised the farmers that the issue will be resolved. This will put more pressure for the ministry of agriculture to engage only reputable seed companies.



The President himself inspects the seed subsidy quality
Source: detik.com, suara.com

With a renewed focus on agriculture, we re-iterate our view that we are about to re-enter the golden era of agriculture. If you are interested in why are so positive, then please read our 4Q 2015 report in which we discuss this in great detail.

Indonesian grassroots spending shows signs of growth

In our earlier reports we conveyed that Heyokha team tries to push aside rigidity in thinking and spends a lot of time on the road to understand the investment consequences of the agricultural reforms.

From these trips it became apparent to use that the government programs aimed at improving farmers lives are working, and expected their spending to grow.



The trips took us to places that are only 50 - 950 km away from Jakarta, but somehow not yet visited by mainstream stock analysts. The beautiful scenery is an added bonus while learning about farmers.
Source: Heyokha

The first quarter 2016 results from Indonesian companies reinforces our view that basic grassroots consumption of low ticket items is recovering strongly.

Mass market retailers like Alfamart (AMRT IJ) / Indomaret posted very strong sales growth of 30% YoY in IQ 2016. Mayora (MYOR IJ) posted a staggering 45% growth for the domestic market. Mayora (MYOR IJ) even explicitly stated that stronger demand for their products (driven by volume rather than price) was attributable to the government program aimed towards mid/low consumers. Bread maker Sari Roti (ROTI IJ) saw sales increase by 18%.



Typical items being sold in a village warung (the neighborhood shop). Kapal Api coffee (left) is a must-have item for a civilised conversation and with respect to cigarettes, people typically prefer the full flavor options, the "real cigarette" (right). In fact, sales of the Torabika coffee brand (MYOR IJ) went up by 30% in IQ16 YoY.
Source: Heyokha

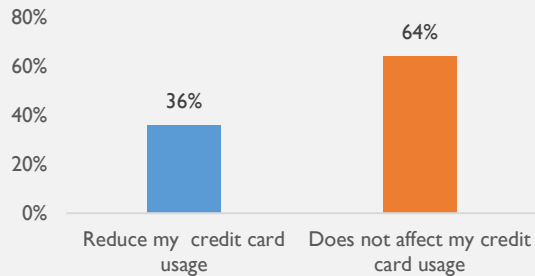
At the same time, we witness premium items such as the products of Kalbe (KLBF IJ), Unilever (UNVR IJ) and Sampoerna (HMSP IJ) to have experienced a more fragile recovery.

Higher-end specialty retailers such as MAPI (MAPI IJ), Ace Hardware (ACES IJ), and big ticket size grocery retailer such as Hypermart (MPPA IJ) also saw a declining trend on same-store sales growth (SSSG).

Another possible explanation could be the tax officer that plan to take a peek on credit card usage to obtain more tax revenue. This has caused a decline in retail sales according to a survey by a local brokerage house.

How will government's access to credit card transaction affect your credit card usage?

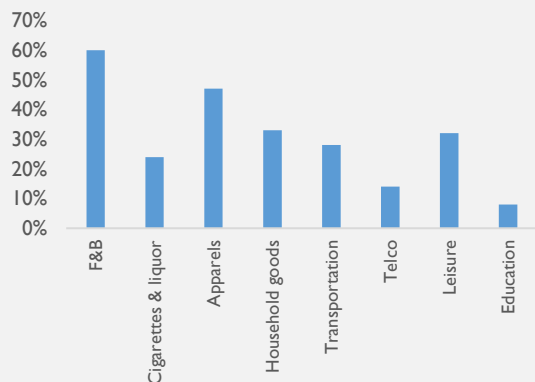
Based on 39 respondents



Source: Sucorinvest

Where will you reduce your credit spending?

Respondents can choose more than one answer



Source: Sucorinvest

While it's true that Jokowi's more inclusive growth ambition also resonates with the urban dwellers, we would expect sales in farming regions to increase to a larger extent, for one particular reason: farmers' income is rising thanks programs from the government aiding to reduce costs (seed and fertiliser subsidies), higher farm productivity, and firmer prices for rice and corn.

Based on what we experienced during our trips to meet farmers, we believe the sales recovery described above is just the beginning.



Urban spending remains challenged, discretionary and premium good sales are feeble in general. Rural spending is the bright spot?
Source: Heyokha

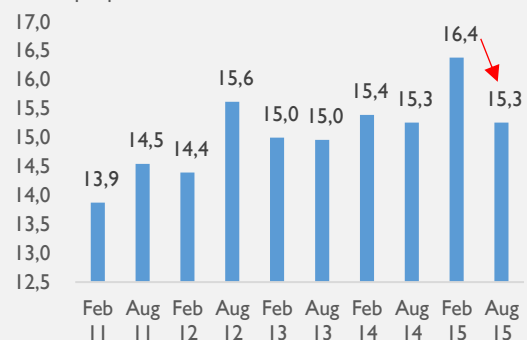
In contrast, we do see some job retrenchment in the urban areas. Commercial bank employees rank amongst the most targeted.

For example, in 2015, Maybank Indonesia (BNII IJ) let go 289 employees after sending 459 to early retirement in the previous year. CIMB Niaga Bank (BNGA IJ) let 1,426 employees go last year. Bank Danamon (BDMN IJ) and Citigroup Indonesia also laid off employees; the list goes on and on.

On the manufacturing front, Toshiba and Panasonic have ceased their manufacturing activities in Indonesia.

Employment in manufacturing sector

In million people



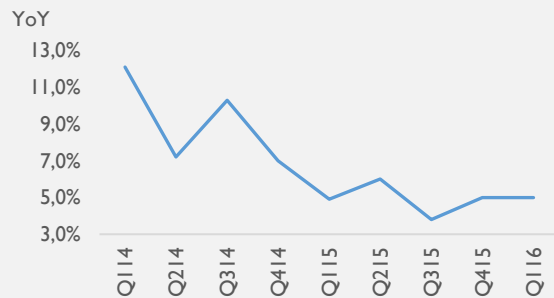
Source: National bureau statistics

The job losses in the cities should help to explain lacklustre sales of premium and discretionary items. The trend of premiumisation that we saw few years ago seems to be reversing.

The charts below highlight the tale of premium vs. grassroots consumerism:

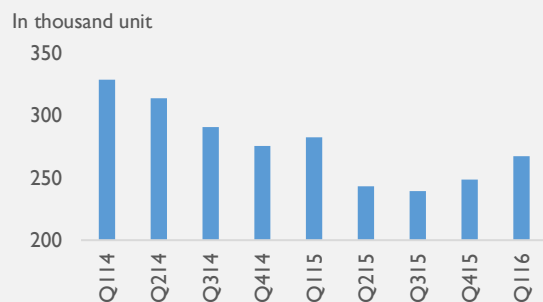
Premium sales struggling...

Mitra Adi Perkasa Same-Store sales growth



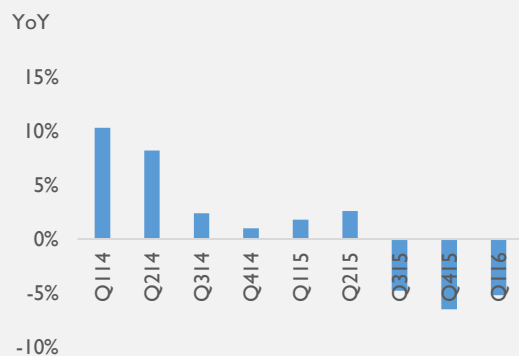
Source: Company data

Four-wheeler sales



Source: Gaikindo

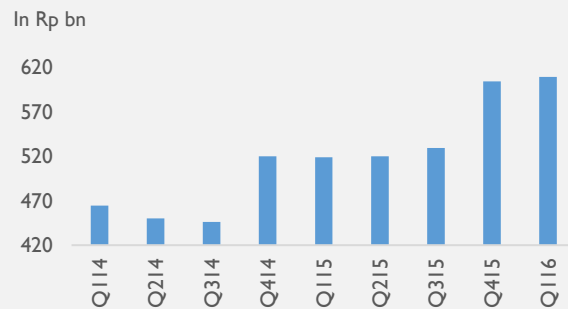
Hypermart Same-Store sales growth



Source: Company data

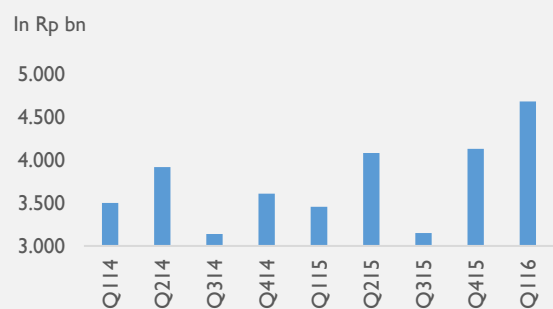
While grassroots sales trending up...

Sari Roti sales



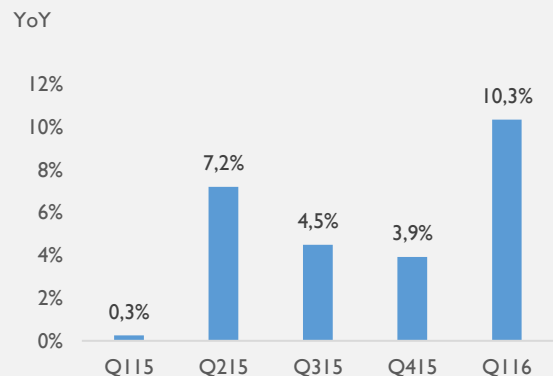
Source: Company data

Mayora Indah sales



Source: Company data

Alfamart Same-Store sales growth



Source: Company data