FRANKLIN TEMPLETON INVESTMENTS

Templeton Emerging Markets

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MARKET VIEWS

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Overview

Renewed investor confidence and the return of bargain investors led markets to continue the upward trend witnessed in March. The MSCI Emerging Markets index returned 16.7% in US dollar terms in April, after recording a 14.4% increase in March. Part of this return was due to weakness in the US dollar, as investors shifted funds into higher yielding international assets.

Asian and Latin American markets ended the month with strong returns as the asset class continued to attract fund inflows. After a period of underperformance due to concerns about the financial welfare of the region's banks, Eastern European markets became the strongest performers in April. Hungary and Poland returned more than 25% in US$ terms, while Russia ended the month up 21.9%. Turkey was among the top emerging market performers with a return of close to 30% in April. A stronger Rand led the South African market to end April with an 11.6% gain in US dollar terms.

An outbreak of swine flu towards the end of the month in Mexico's capital city led to fears of a global pandemic. Apart from North America, however, spread of the virus appeared to be well contained in other parts of the world. Mexican and U.S. authorities had since reported that the virus was not as severe as previously feared. The world is also better equipped to deal with the virus due to its experience with the bird flu outbreak some years ago. As a result, investor confidence remained unaffected.

Regional Update

Asia

China's GDP growth grew 6.1% y-o-y in the first quarter of 2009, compared to 6.8% y-o-y in the last quarter of 2008. This was mainly due to a decline in export growth and lower manufacturing and industrial growth. Investment in fixed assets, however, increased 28.8% y-o-y, as government efforts to boost economic recovery showed results. Credit growth also accelerated with new loans reaching US$671 billion in the first quarter of 2009, higher than the total for the entire year in 2008. Consumer prices continued to ease in March with a 1.2% y-o-y decline due to lower transport and housing costs. This compared to a 1.6% y-o-y fall in February. Showing signs of improvement, industrial output grew 8.3% y-o-y in March from 3.8% y-o-y in the first two months of the year.

Economic recovery, supported by the government stimulus package, is expected to continue. Cooperation between mainland China and Taiwan continued with both sides signing agreements to maintain financial stability, combat crime and increase cross strait flights. China and Kazakhstan also vowed to enhance bilateral trade and economic relations.

Government efforts to stimulate **South Korea**'s economy showed some results in the first quarter of 2009 with GDP growing 0.1% q-o-q, after declining 5.1% q-o-q in the last three months of 2008. Private consumption grew 0.4% q-o-q, after recording a 4.6% q-o-q decline in the previous quarter, due to greater consumer spending as a result of tax cuts, lower interest rates and a decline in oil prices. Government expenditure rose 5.3% q-o-q, compared to a 3.0% q-o-q decline in the preceding quarter. Exports declined 4.2% q-o-q, better than the 8.9% q-o-q decline reported in final quarter of 2008. After cutting its benchmark interest rate by a total of 325 basis points (3.25%) in the last six months to support the domestic economy, the Central Bank left the rate unchanged at a record low of 2.0%. In an effort to support the financial sector, the Financial Services Commission launched a US$15 billion fund to recapitalize the country's largest banks.

Latin America

The **Mexican** government forecast the economy to contract by 2.8% in 2009 as a result of the current global economic environment. A recovery, however, is expected to 2010 with a GDP growth forecast of 2.0%. The International Monetary Fund (IMF) approved a US$47 billion credit line for Mexico under its new Flexible Credit Line facility as a precautionary measure. The Central Bank continued to lower interest rates in April as part of efforts to stimulate the domestic economy. The Bank reduced its benchmark interest rate by 75 basis points (0.75%) to 6.0%. Inflationary pressures maintained a downward trend due to lower domestic demand. Consumer prices fell to 6.0% y-o-y in March, after reaching a peak of 6.5% y-o-y in December.

The **Brazilian** government announced additional measures to support the economy. These included higher deposit guarantees to improve liquidity in the financial sector, a housing plan which aims to provide 1 million new homes to low-income families, and tax breaks in the automotive and construction materials sectors. The Central Bank maintained a loose monetary policy in April by cutting its benchmark interest rate by 100 basis points (1.0%) to 10.25%. Inflationary pressures continued to ease with consumer prices increasing 5.6% y-o-y, within the Bank's target range of 2.5%-6.5%, mainly due to weaker domestic demand and lower global commodity prices. Brazilian President Lula met Chinese President Hu Jintao in April where both sides agreed to expand bilateral relations and increase cooperation in areas such as oil, infrastructure and finance.

Africa

South Africa's general elections were held in April where the ruling African National Congress (ANC) Party emerged victorious, but narrowly missed achieving a two-thirds majority. Party leader Jacob Zuma is expected to become the country's next president after a parliamentary vote next month. Economically, weakness in the manufacturing sector continued with volume declining 11.1% y-o-y in the first quarter of 2009 as a result of weak global and domestic demand. The result was, however, much better than the 21.8% y-o-y contraction in the preceding quarter. Consumer prices rose 8.5% y-o-y in March, in line with the 8.6% y-o-y increase recorded in February.

Europe

After increasing the benchmark interest rate by 300 basis points (3.0%) in 2008, Russia's Central Bank switched to a loosening monetary policy in April by cutting its benchmark interest rate for the first time since June 2007. The interest rate was reduced by 50 basis points (0.5%) to 12.5%. Consumer prices increased 14.0% y-o-y in March, in line with the 13.9% y-o-y increase in February. Lower commodity prices, reduced export demand and tighter credit conditions led industrial production to contract 13.7% y-o-y in March, its fifth consecutive monthly decline. Unemployment rose to 9.5% y-o-y in the first quarter of 2009 due to staff reductions resulting from weaker domestic and export demand.

The **Turkish** government adjusted its GDP forecasts for 2009-11in April. GDP is expected to contract 3.6% in 2009 and subsequently recover in 2010 and 2011, with growth forecasts of 3.3% and 4.5%, respectively. The IMF and Turkey agreed to restart stalled talks on a three-year stand-by loan agreement valued at US$25 billion-US$45 billion. The Central Bank maintained an easing monetary policy to support the domestic economy. The Bank reduced its benchmark interest rate by 75 basis points (0.75%) to 9.75%. Aimed at improving regional trade and economic relations, Turkey signed numerous agreements with Sudan, Bahrain and Iraq signed agreements.

Feature of the Month: Q&A on Emerging Markets with Mark Mobius

What's your assessment of the global economy?
The global economy is in a situation where individuals, companies and economies are in a strong position to overcome the global crisis with support from their governments and central banks. We also believe that emerging markets will play a much greater role in the global economy. Countries such as China and India are expected to emerge as leaders due to their relatively stronger macroeconomic and financial positions.

In which regions are you most optimistic about investment opportunities?
Since it’s usually possible to find at least a few bargains in most markets, all emerging market regions are looking exciting; this is especially the case now, in view of the recent corrections. While global growth has slowed, emerging markets are still expected to grow at a much faster rate than developed markets. The accumulation of foreign exchange reserves also puts emerging economies in a much stronger position to weather external shocks with reserves, for example, in China, totaling nearly US$2 trillion. More importantly for us as value investors, the current valuations of emerging markets are attractive. Certain countries such as Turkey and Russia are now trading at single-digit price to earnings ratios.

Asia is the largest emerging market region in the world. Asian countries are also growing relatively fast. They include countries like China and India with very large populations whose per capita income is growing, and capital markets in those countries are undergoing rapid development. Economic growth remains relatively high, per capita incomes have been rising, valuations remain attractive and reforms continue, thus improving the region’s business and investment environment.

Valuations in Eastern European markets are also attractive, very attractive in some markets such as Hungary and Turkey which are trading at low single-digit P/Es. Poland is one of the few countries in the region that is expected to record positive GDP growth in 2009. Its valuations are, however, are not as attractive as some of its regional peers. Russia is another interesting market. With its huge land mass, large population and abundant natural resources, the country could become one of the fastest-developing economies in the longer-term.

Most Latin American economies are faring relatively well taking into account the current global macroeconomic conditions. There are selective countries which are more prone to the global downturn. For example, Mexico, but greater inter-regional trade has offset some of the adverse impact of lower export demand from the U.S. One of the region's main attractions is its huge consumer market with pent-up demand for goods and services and world-class companies that are at the same time under-leveraged and inexpensive. In addition, the region’s natural resources are among the largest in the world. Countries such as Chile and Peru which are among the world’s leading copper producers. Mexico is a net exporter of oil. Brazil is a major exporter of iron ore, and soft commodities such as soybeans and coffee as well. Colombia is also exports commodities such as oil, coffee, coal, and so on. While commodity stocks have been negatively affected by the recent decline in commodity prices, many companies are still profitable at current price levels.

In addition, frontier markets, which are the emerging markets of the future, are starting to look interesting. For example, the Middle East is of great interest and we believe the potential for economic growth and development remains considerable, especially if the current trend toward the implementation of political and economic reforms remains on course. Africa is another area we’re excited about. In addition to South Africa, regional economies are also beginning to look attractive.

In your opinion, what are the biggest threats to the global economy?

- loss of confidence
- excessive or poor regulation
- adoption of protectionist measures
- abandonment of the market economy philosophy

Why are you so positive about the outlook for emerging markets?

One key reason is the rapid growth of money supply, not only in the U.S. but all over the world. Governments are trying their best to avoid deflation by pumping money into the economic system. This money must find a home and current savings interest rates, for example, for the US dollar, is not very warm and cozy. Investors have already begun to show renewed confidence and are seeking better returns. The obvious choice is equities. Specifically for emerging markets, we are optimistic because emerging markets:

- are undervalued, trading at extremely attractive valuations and have strong fundamentals
- have undervalued domestic currencies
- are expected to grow, in aggregate, faster than the developed countries
- will emerge as leaders due to their relatively stronger macroeconomic and financial positions.
- have strong holdings of foreign reserves, allowing them to better withstand any external shocks
- follow prudent fiscal policies
- have expanding trade and economic relations with each other; lowering their dependence on developed markets
- represent a huge consumer market as well as a large labor force
- have abundant natural reserves in countries such as Russia, Brazil and South Africa
- have strong potential for development in areas such as infrastructure