



FRANKLIN TEMPLETON
INVESTMENTS

Emerging Markets Overview

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Overview

The MSCI Emerging Markets index ended the month of November 2009 with a 4% gain in US\$ terms. Many of the emerging markets continued to show improving economic conditions, which resulted in continued strong inflow of funds into emerging equity markets.

Year-to-date, emerging markets were up 72%. There was some concern towards the end of the month when the Dubai government-owned Dubai World announced a six-month debt standstill. The group, struggling under US\$59 billion of debt, would not be meeting their debt obligations for the next six months while a restructuring is arranged. The negative news impacted markets globally, particularly in Asia and Europe because a number of banks are exposed to Dubai debt and several international construction companies have had large contracts in Dubai. Most markets rebounded quite quickly after it was ascertained that damage to companies outside of the gulf region would be very limited.

As we have said in the past, in any bull market we expect that there will be corrections along the way. In our view, these corrections can be quite healthy, because to us it means that valuations will become more reasonable, presenting buying opportunities. This kind of volatility in emerging markets is what we expect and why it is so important to have a long-term investment horizon. We view these opportunities as a time to continue holding quality investments and to increase our holdings in selected stocks that we believe, over a five-year time frame, will continue to show stable financing and good earnings.

Regional Update

Asia

In **China**, economic data released during the month continued to show signs of improvement. Foreign direct investment (FDI) recorded growth for the second consecutive month in September, following contractions between October 2008 and July 2009. FDI rose 19% y-o-y in October to US\$7.9 billion. This brought the year-to-October total inflows to US\$63.7 billion. The decline in exports continued to moderate in October with a 14% y-o-y drop compared to a 15% y-o-y decrease in September and 26% y-o-y fall in May 2009. Value added output growth also continued to strengthen. Output grew 16% y-o-y in October, compared to an increase of 14% y-o-y in September, and its strongest growth rate thus far this year. The increase has been mainly driven by infrastructure investment resulting from the government's stimulus measures. U.S. President Obama visited China in November where he met Premier Wen Jiabao and President Hu Jintao. Both countries agreed to continue dialogue and work together on a wide range of issues including economic recovery, anti-terrorism and climate change.

MARKET VIEWS

South Korea's trade balance continued to improve in October. The decline in exports eased to 8% y-o-y in October from double-digit drops experienced earlier during the year. The improvement in exports over the year resulted from currency devaluation which boosted the competitiveness of Korean exports as well as a rise in global trade. The signing of a free trade agreement with the European Union in early 2010 could further support export growth. Imports also posted their smallest contraction during the month. The trade surplus rose to US\$3.8 billion, nearly four times the US\$1 billion, a year earlier. Industrial production growth also strengthened largely due to a recovery in external demand. Production growth increased to 11% y-o-y in September from 1% y-o-y in August.

Latin America

Pointing towards a continued recovery in **Brazil's** retail sector, sales increased 9% y-o-y in September and 4% y-o-y for the first nine months of 2009. This compared to a growth of 5% y-o-y in August. While the main driver of growth was the automobile industry, sectors such as clothing, office supplies and publishing also recorded positive sales volume growth. The industrial sector continued to improve with output rising 1% m-o-m in September. This marked the ninth consecutive month of growth. However, on a y-o-y basis, industrial production was 8% lower. This, was however, much better than the 15% y-o-y decline in April 2009. In October, exports, in the meanwhile, recorded their smallest annual decline in four months with a 23% y-o-y decline to US\$14.1 billion. Imports were down 26% y-o-y, its smallest contraction since March 2009. A trade surplus of US\$1.3 billion was recorded for the month, unchanged from a year earlier.

Mexico's GDP declined 6% y-o-y in the third quarter of 2009, compared to a contraction of 9% in the preceding two quarters, an indication that the worst may be over. Growth in the mining, as well as easing contractions in sectors such as services, commerce activity and manufacturing, supported the economy. The 2010 budget received final approval from the Congress in November and included a 1% increase in the current sales tax to 16%, an increase in income tax for high earning individuals and businesses to 30% in 2010-12 and higher levies on beer and tobacco. The 2% consumption tax, was however, rejected while the 4% tax on telecommunications services was reduced to 3%. Government expenditure will also be increased in areas such as infrastructure, agriculture and education while reducing the government's operational costs by implementing personnel cuts and salary freezes.

Africa

The **South African** economy returned to growth in the third quarter of 2009. GDP rose 1% y-o-y, compared to a decline of 3% y-o-y in the second quarter. Key contributors to growth included the manufacturing, government services and construction sectors. Inflationary pressures continued to ease, with consumer prices reaching a two-year low of 6% y-o-y in September. This was in line with the Central Bank's 6% target ceiling. The country's current account deficit is expected to decline to 5% of GDP in 2009 as imports contract at a faster pace than exports as a result of the weak economy.

Europe

The **Russian** Central Bank maintained an expansionary monetary policy in November to stimulate lending. The Bank reduced its key refinancing interest rate by 50 basis points (0.5%) to 9%. This brought the cumulative reduction in the rate to 4% since April 2009. In an effort to strengthen relations with Sri Lanka, Foreign Minister Sergey Lavrov visited the country at the end of October. In addition to discussions on a number of subjects such as terrorism, international affairs and economic co-operation, several bilateral agreements relating to areas such as education, culture and tourism were also signed. Russia and Cyprus signed an agreement to avoid double taxation and improve the transparency of economic relations between the two countries.

The **Turkish** Central Bank maintained an expansionary monetary policy in November to support the country's economic recovery. The Bank cut its benchmark borrowing interest rate by 25 basis points (0.25%) to 6.5%. This was smaller than the 0.5% cut seen in the last six consecutive months. Inflation continued to ease with consumer prices remaining well below the Bank's year-end target. Aimed at boosting bilateral ties, Turkey and Jordan agreed to sign a Free Trade Agreement (FTA), which was previously stalled, by the end of the year.

Feature of the Month: Two Leading Emerging Market Regions

Asia and Latin America are probably the most interesting emerging market areas in the world. This is not only because of their different cultures but also because their economic histories have been so varied. If we consider the performance of markets in both areas, the Asian investor might be misled to think that Asian markets have outperformed Latin American markets but that is not necessarily the case in all time periods. For example up to November of this year, the MSCI AC Asia ex Japan Index was up 65% in US\$ terms while the MSCI Latin America Index was up 100%. In 2008, the performance of both areas was about the same with Asia moving down 52% and Latin America falling 51%, a slightly better performance than Asia. In 2007, Latin America again beat Asia. While Asia was up 41%, Latin America was up 51%. Again in 2006, while Asia was up 34%, Latin America recorded a bigger rise of 44%. Of course there have been periods when Asia performed better than Latin America but recent history shows that Latin America has been the leader in performance rankings.

If we look at the demographic, geographical and economic characteristics of the two regions, there are some significant differences as well as similarities. Let's take population; while Asia's population numbers 3,600 million, Latin America's population is only 550 million. Population growth in Asia has been slightly lower than that of Latin America. Between 2003 and 2008, Latin America's population grew by 1.3% while Asia's grew by 1.2%. One strong benefit that Latin America's population has is that they have more land available to them. While Asia's land mass is 25 million square kilometers to hold that 3,600 million people, Latin America has 20 million square kilometers to hold 550 million, a clear difference.

In the economic arena, growth in Asia has been superior to that of Latin America. Between 2003 and 2008, while the average annual growth rate in Asia was 8%, it was 5% in Latin America. This year we expect Asia's growth to be flat but Latin American economies will shrink it's economies by an average of 2.5%.

Of course despite the slower growth in Latin America, total GDP is, on a per capita basis, better than Asia. In 2008, Asia's GDP totaled US\$9,180 billion so that the per capita income was about US\$2,600 while Latin America's GDP was lower at \$4,170 billion but its smaller population resulted in a per capita income of \$7,580, significantly higher than that of the Asians.

In the foreign reserves area, Asia is definitely the superior with reserves now surpassing US\$3,500 billion while in Latin America, total reserves amount to only about US\$500 billion. Although Asian exports and imports amounted to US\$7,300 billion in 2008, compared to Latin America's US\$1,700 billion, the growth of trade for both regions has averaged about the same during the last five years with an annual average growth of 19%.

Looking at the stock markets in both regions, the market capitalization of Asian stock markets has reached US\$9,510 billion compared to Latin America's US\$1,814 billion. Asia also has many more listed companies with about 15,200 stock exchange listings compared to Latin America's 1,300.

We continue to find good value in Latin American stock markets despite the smaller size compared to Asia. Currently, the price/earnings ratios of both areas average 14x, while the price to book value ratios are also the same at about 2x. Dividend yields differ though, with Asia at 2% and Latin America with 3%. The large markets in Asia are China and India where the emphasis is on manufactured goods and services while in Latin America Brazil, the dominant country, is strong in commodity exports. Nevertheless, we are finding opportunities in almost all sectors in both regions with a number of good manufacturing, consumer and banking stocks throughout Latin America and Asia.

As such, the future of both regions is good and holds a great deal of promise for investors, which is why investors should have exposure to both regions. This will enable investors to benefit from the developments in Latin America and Asia.

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