



FRANKLIN TEMPLETON  
INVESTMENTS

# Emerging Markets Overview

MAY 2009

*By Dr. Mark Mobius, Executive Chairman, Templeton Asset Management Ltd.*

## Overview

Emerging markets recorded double-digit returns for the third consecutive month in May. The MSCI Emerging Markets index returned 17.1% in US\$ terms. Part of this return was due to weakness in the U.S. dollar. This brought the year-to-May return to nearly 40%. The desire for higher returns, a return of confidence in emerging markets and the search for undervalued companies support the markets' uptrend.

Eastern European markets remained the strongest performers with Hungary ending the month up 27.3% and Russia returning 31.9%. Turkey gained 15.1% after a 29.7% return in April. South Africa performed in line with its emerging market peers with a 16.3% return for the month. Stronger domestic currencies and higher commodity prices supported Latin American markets. Asian markets continued to attract significant portfolio inflows allowing markets such as China, India, Thailand and Taiwan to record double-digit returns. South Korea, on the other hand, underperformed with a 4.1% return, on rising geopolitical tensions with North Korea on news of the latter's nuclear tests during the month.

## Regional Update

### Asia

After a very strong first quarter, credit growth in **China** slowed in April with new banking lending totaling US\$87 billion. New loans totaled US\$670 billion in the first three months of the year. The Central Bank, however, said that ample liquidity would be maintained to support the domestic economy. China continued efforts to boost relations with its trading partners in May. Brazilian President Luiz Inacio Lula da Silva and President Hu Jintao signed a number of agreements pertaining to areas such as science, law, finance, energy and agriculture during the former's recent trip to China. Moreover, Premier Wen Jiabao visited Europe in May to attend the 11th China-European Union (EU) summit. In addition to increasing trade and economic relations, both sides also signed three agreements to cooperate on clean area, technology and small- and medium-sized companies.

**South Korea** registered a record high current account surplus of US\$6.7 billion in March, as imports declined faster than exports due to slowing economic growth. This compared to a surplus of US\$3.6 billion in February. Recording a double-digit decline for the fifth consecutive month, industrial output showed signs of moderation with a better-than-market expected 10.6% y-o-y decline in March. South Korean and EU trade ministers agreed to accelerate the completion of the bilateral trade agreement with additional talks planned for June. The National Assembly ratified a supplementary budget totaling US\$23 billion in addition to the existing US\$230.4 billion budget for 2009 to support the domestic economy.

MARKET VIEWS

## Latin America

The **Mexican** economy contracted 8.2% y-o-y in the first quarter of 2009, as a result of declines in the manufacturing, construction, retail and tertiary services sectors. The government forecasts 2009 GDP to decline 4.1% y-o-y and the public sector deficit to be 1.8% to 2.0% of GDP. Bank of Mexico Governor Guillermo Ortiz expects annual GDP growth to turn positive in the final quarter of 2009 or the first quarter of 2010. A recovery in demand for Mexican exports in the next three months was also a possibility, according to the governor. Inflationary pressures continued to ease, albeit at a slow pace, mainly due to weaker domestic demand. Consumer prices rose 6.0% y-o-y in March, compared to a 6.2% increase in February.

The **Brazilian** government lowered its GDP growth forecast for 2009 to 1.0% y-o-y from 2.1% y-o-y in view of slowing growth globally. Brazil's trade surplus totaled US\$3.7 billion in April, more than double the US\$1.7 billion recorded a year earlier. Strong Chinese demand for raw materials such as soybeans, iron ore and raw sugar boosted export revenues, which totaled US\$12.3 billion. Imports declined 26.6% y-o-y to US\$8.6 billion as a result of weaker domestic demand. Aimed at further boosting trade and economic relations, President Luiz Inacio Lula da Silva and Chinese President Hu Jintao signed a number of agreements pertaining to areas such as science, law, finance, energy and agriculture during the former's recent trip to China. Lula also visited Turkey where both sides vowed to further develop bilateral relations.

## Africa

The **South African** Reserve Bank cut its benchmark interest rate twice in May, each time by 100 basis points (1.0%) to end the month at 7.5%, on news that the economy was officially in a recession and inflation remained relatively high. GDP declined 1.6% q-o-q and 6.4% y-o-y in the first quarter of 2009. Double-digit declines in the manufacturing and mining sectors had the largest impact on growth. The construction sector, in contrast, contributed to economic growth with a 9.4% increase in government infrastructure. Manufacturing output contracted 22.1% y-o-y, while mining and quarrying output declined 32.8% y-o-y in the three-month period. Consumer prices rose 8.4% y-o-y in April, in line with the 8.5% y-o-y increase recorded in March. Prices, however, slowed significantly on an m-o-m basis with a 0.5% increase in April, compared to a 1.3% increase in March.

## Europe

**Russia's** Central Bank maintained an expansionary monetary policy in May by cutting its benchmark interest rate by 50 basis points (0.5%) to 12.0%. Consumer prices eased to 13.2% y-o-y in April, a 14-month low. Russian officials undertook a number of overseas trips during the month to increase economic ties with its trading partners. Prime Minister Vladimir Putin paid a visit to Japan to discuss increasing bilateral relations in the energy and business sectors. Trade between the two countries has grown to nearly US\$30 billion in 2008 from about US\$5 billion in 2000. Putin also visited Mongolia to boost cooperation in the areas of trade and economy with the signing of agreements in pertaining to areas such as agriculture. Additionally, Deputy Prime Minister Sergey Ivanov met Armenian President Serzh Sargsyan to expand strategic relations between the two nations.

**Turkish** Prime Minister Recep Tayyip Erdogan reshuffled his cabinet during the month. Former Foreign Minister Ali Babacan was appointed as State Minister and Deputy Minister responsible for the Turkish economy. Babacan is expected to take over negotiations with the International Monetary Fund (IMF) for a new loan agreement from Mehmet Simsek who became the new Finance Minister. Brazilian President Luiz Inacio Lula da Silva visited Turkey in May where both sides agreed to further develop bilateral ties. As part of its economic stimulus package, the government extended the list of goods that were eligible for a reduction in value added tax to 8% from 18%. Economically, industrial output weakened 20.9% y-o-y in March as the weaker global economy continued to impact export demand. Despite the double-digit contraction, the decline was an improvement from the 23.8% y-o-y drop in February.

*Feature of the Month: Q&A on Emerging Markets with Mark Mobius, Executive Chairman, Templeton Asset Management Ltd.*

**Emerging markets have been outperforming thus far in 2009, do you think this trend will continue for the rest of the year?**

Although we are optimistic about the opportunities for upside potential, it is important to realize the volatility is still with us and will be with us for some time. This means that there will be periods when the markets go down as well as periods when they go up. We should therefore take advantage of dips in the markets to buy stocks cheaply, paying attention to valuations and long-term earnings growth prospects in order to avoid buying or holding expensive stocks. We continue to find good value in markets like China, Thailand, Brazil, Mexico, Turkey and South Africa.

**What sectors are you looking at now?**

Commodity stocks look attractive because many of them have declined below their intrinsic value and we expect the global demand for commodities to continue its long-term growth. Consumer stocks also look attractive. With rising per capita income and strong demand for consumer and other goods, the earnings growth outlook for these stocks is positive.

**Will the global equity market retest the low point in March?**

There is always the possibility of this happening and it could be triggered by something totally unexpected, such as war breaking out on the Korean peninsula or a massive global flu pandemic. As I have said, markets will continue to be volatile as global economies remain fragile and we should see rises and falls in the months ahead.

**Which country do you expect to be the best performer from the BRIC markets?**

That would be impossible to say at this time but we think China has a good chance of achieving that goal. Of course, I'm talking about measuring that move from the beginning of this year. Russia also looks very undervalued.

**In view of China's strong market performance, would you say that it's in a bull market?**

You can see that it is a bull market since the increase has been so dramatic but it would be difficult to call it a sustainable bull market in view of its very sharp rise. I still feel that we will face volatility and there will be corrections along the way. We, do however, expect China to continue to take lead the global market recovery.

**Will the Chinese government propose another stimulus package in 2009? Why?**

That all depends on the success of the measures already in place. They clearly have the resources to do this again. We should expect them to act if current measures and programs do not give the desired results.

**You mentioned in October that Russia's cheap stocks were an once-in-a-lifetime opportunity. Since then, the RTS Index in Russia fell a bit more to 498, then subsequently doubled this year. After that great performance, are stocks still a good value, or is it time to take a breather?**

Russian stocks still look cheap. Yes, they have risen dramatically from their low point but they are still a long way from their previous high. Of course, the P/E has risen this year but Russian stocks, as represented by the MSCI Russia index, are still trading at a single-digit P/E of 6.8x as of end-May, 2009, an increase from an even lower 3.4x as of end-December 2008.

**Do the economic problems within Russia--unemployment rising to 10 percent, inflation at 13 percent, and possible GDP contraction of 6 percent--undermine the investment case for the country right now?**

These factors will have a short-term impact on the market, but we always evaluate companies on a long-term basis – taking a five-year view. Thus, we are in fact able to benefit from buying stocks at cheaper prices now.

**Do you see any parallels between the market crash in Russia of 1998 and the one over the last year? Is there fear focused on this market that leads to sharper crashes than elsewhere? Did you learn anything in 1998 about Russia that helped you navigate this crisis?**

No, because Russia and most other markets are in a much stronger position, financially and economically, than they were in 1998. Russia built up strong foreign exchange reserves and trade surplus which has enabled it to withstand external shocks to its economy.

The Russian market was also affected by the correction in commodity prices due to its high exports of oil and other commodities, as opposed to any extraordinary fear focused on this market. However, we maintain the view that commodity prices will continue to increase in the long-term due to greater demand from emerging markets and a relatively inelastic supply. This shall, thus, benefit Russia in the future.

The most important lesson we've learnt from 1998 or any other crisis is that markets always recover - it's just a matter of time. Thus, one should always maintain a long-term and patient view to investing.

**Lastly, you have been investing in the emerging markets for the last 4 decades. Being an expert in investing in emerging markets, do you have any advice to share with investors during the recent market situation?**

It is very important for investors to remember some key principles: (1) diversify - it is important to diversify in order to minimize risk - this is why investing in a diversified mutual fund is best for investors, (2) look globally - no country has a monopoly on good opportunities so you must search globally - this is why we have global emerging market funds, (3) be patient - don't expect to obtain quick gains - the long term investors do best, (4) don't invest unless you understand the

investment your are making - understanding will strengthen your confidence and enable you to make long term investments.

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