Beyond the Headlines: Finding Opportunities in Today’s Markets  
March 29, 2017  
by Edward Perks, Sonal Desai, Stephen Dover, Chris Molumphy  
of Franklin Templeton Investments

With markets reacting in part to geopolitical events, it’s hard not to be distracted by news headlines. To help sift through some of the noise, several of our senior investment leaders recently participated in a roundtable discussion of the events shaping the global markets today, the implications for investors and where they see potential opportunities ahead. Here, we share an excerpt from the roundtable.

**Ed Perks:** In the United States, we see faster growth potential—potential for higher earnings, higher cash flow and higher dividends. At the same time, we see more differentiation within sectors and among individual stocks. I think this environment is well suited for active managers like us to hopefully differentiate as we move forward during this cycle.

With the sharp improvement in business and consumer sentiment—among other factors—markets generally have been embracing a bit of a reflation trade and expectations for accelerating growth. I think we are starting to see a change in perception of what companies will ultimately deliver in terms of their ability to maintain attractive profit margins, in conjunction with positive potential policy shifts, including lower taxes and reduced business regulation.

We think US stocks on a relative basis still have a pretty strong appeal, and we acknowledge there is potential for further upside, but not without risks we need to monitor. Reflation can be positive, but there is another side to that coin; inflation, rising input costs and rising wage pressures all can be problematic and offset some of the positive aspects.

Globally, on the equity side, there has been underperformance in a number of regions versus the United States, and valuations are generally a bit lower, which we find interesting. I think the expectations are also quite low. Strong multinationals playing broad themes with exposure to the US economy and to emerging-market economies look interesting to us.

**Sonal Desai:** Looking broadly across the globe, we believe many people are overestimating the negative or catastrophic impact of trade policy on emerging markets. There are still many, many potential opportunities there, in our view.
Touching on Latin America, we view it as a region that experienced a wave of populism similar to what we are now seeing in several developed countries—except they went through it 10 years ago. We are now seeing a move away from populism in some of these countries, including Argentina and Brazil.

Then there are countries like Mexico and Colombia, which never really went in that direction and have just had an extended period of extremely good policies. We see attractive opportunities at attractive valuations in many parts of Latin America.

We are taking the risks of populism quite seriously. I think most people are, to some extent, underestimating how important this current wave of populism is. The driver of this wave of populism—immigration—is an immediate issue for the average person, not something esoteric like budget deficits. Immigration is a big issue across Europe right now.

We think policies in the euro area will likely have to adjust a bit to this wave of populism. In terms of how disruptive it will be for the markets, I think the coming few months should let us know.

**Stephen Dover:** I would say the biggest opportunity is understanding how emerging markets have changed and with that recognizing some of the emerging opportunities, particularly in the technology area. In terms of a region or an area our team views as a bright spot right now, that would be Latin America in general.

Additionally, we have seen an earnings improvement and improving valuations in emerging-market companies, and we think that with corresponding currencies already perhaps undervalued, that offers more opportunity.

Overall, emerging markets have been faring well. If you looked back at some of the negative headlines last year, including great concerns about trade and the US dollar rising, you would have thought emerging-market equities would perform poorly, but emerging markets generally outperformed developed markets in 2016.¹

We think emerging markets are probably better prepared overall for rising US interest rates than they have ever been. Rising rates are priced into the market already, in our view. And, trade is developing in a very different way today than in the past, where emerging markets were primarily selling low-cost goods to developed markets.

I think the biggest risk today is just (unwarranted) panic and distraction, and I would caution investors not to spend too much time trying to follow politics. We are investing in individual companies, and those companies for the most part are used to dealing with volatility.

We think one of the great advantages we have versus a more passive investment approach is our on-the-ground insight into what is going on in a particular country. For example, when we look at some of the bright spots within the emerging-market universe, such as in Latin America, we see positive changes. In Peru, Argentina and Brazil, we see a lot of potential.

**Chris Molumphy:** Broadly speaking, we are comfortable with corporate fundamentals, so within the
fixed-income space we favor investment-grade, high-yield and leveraged bank loans. I would also mention municipal bonds as an area of the market we think looks interesting. Again, broadly speaking, across states, cities or other local municipalities, the valuations are relatively attractive and fundamentals appear reasonably healthy, in our view.

High yield is among the most equity-like fixed income sectors, and we have seen high-yield valuations increase more recently, similar to the increasing trend in equity valuations. Looking at high-yield valuations on the basis of spread to Treasuries, relative to its own history, we can make the argument that the sector is beginning to appear overvalued given this spread is a bit reduced from long-term averages. However, we view the market fundamentals—investment grade and below—as healthy, and the corporate outlook looks good to us.

In our view, the US economy appears pretty healthy overall. So, we view the Federal Reserve's (Fed's) lifting of its benchmark short-term interest rate (the Federal funds rate) to a target range of 0.75% to 1% in March as an affirmation of this.

We also view the rate hike as a return to a more normalized approach to monetary policy.

We think it is worth pointing out that longer-term Treasuries saw a reasonably positive reaction to the Fed's move on March 15. Longer-term interest rates did not immediately increase; initially, they actually decreased following the Fed's announcement.

This disconnect between short- and long-term rates is important as it dispels the basic notion that all fixed income is a poor investment in a rising-rate environment. Fixed income markets are vast and they are complex—good investment opportunities can be sourced within all different types of market environments.

The comments, opinions and analyses expressed herein are for informational purposes only and should not be considered individual investment advice or recommendations to invest in any security or to adopt any investment strategy. Because market and economic conditions are subject to rapid change, comments, opinions and analyses are rendered as of the date of the posting and may change without notice. The material is not intended as a complete analysis of every material fact regarding any country, region, market, industry, investment or strategy.

This information is intended for US residents only.

What Are the Risks?

All investments involve risks, including possible loss of principal. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. Bond prices generally move in the opposite direction of interest rates. Thus, as prices of bonds in an investment portfolio adjust to a rise in interest rates, the value of the portfolio may decline. High yields reflect the higher credit risk associated with these lower-rated securities and, in some cases, the lower market prices for these instruments. Interest rate movements may affect the share price and yield. Treasuries, if held to maturity, offer a fixed rate of return and fixed
principal value; their interest payments and principal are guaranteed.

Special risks are associated with foreign investing, including currency fluctuations, economic instability and political developments. Investments in emerging markets involve heightened risks related to the same factors, in addition to those associated with these markets’ smaller size, lesser liquidity and lack of established legal, political, business and social frameworks to support securities markets. Such investments could experience significant price volatility in any given year.

1 Emerging markets as reflected by the MSCI Emerging Markets Index, which captures large- and mid-cap representation across 23 emerging-market countries. Developed markets as reflected by the MSCI World Index, which captures large- and mid-cap representation across 23 developed markets. Indexes are unmanaged and one cannot invest in an index. They do not include fees, expenses or sales charges. Past performance does not guarantee future results.

© Franklin Templeton Investments