Emerging Markets to Reward Long-Term Investors

By Mark Mobius
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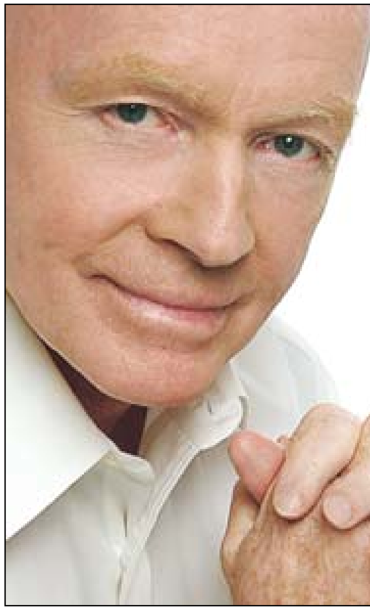
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Recently, we have seen volatility across emerging markets and investors rush to raise cash in an effort to reduce their exposure to these markets.

Given the rout in global emerging stock markets we're witnessing today, I'm not very worried because this is not the first time markets have corrected or that we've witnessed uncertainty in the markets. Investors should expect volatility, as is the nature of any stock market, but we expect long-term investors to be rewarded.

It's impossible for anyone, regardless of how much experience they have in stock markets, to predict exactly how much a market is going to decline before it turns around. No one can predict the market direction and a bear or bull market could start at any time. However, the good news is that bear markets are shorter in duration than bull markets and bear markets go down a smaller percentage than bull market increases. This is why one must invest with a long-term view.

The current market decline is not comparable to the Asian Financial crisis of July and October 1998 for the simple reason that Asian markets, and for that matter most emerging markets, are in a much better position than they were about 10 years ago.

The crisis in 1997/8 began in Asia and spread globally.

Currently, however, Asian economies are better equipped that they were 10 years ago to weather any global issues/slowdown as many have abandoned their pegged exchange rates, decreased short-term debt and built up large current account surpluses and foreign exchange reserves.

Most Emerging markets are in fact now benefiting from stronger economic growth, relatively lower inflation and interest rates, the implementation of effective fiscal and monetary policies, stable political environments, improving corporate governance, the enhancement of competitiveness through removal of subsidies and reduction of trade barriers, higher productivity and consumption because of a younger and better trained labor force, and so forth.

Asia is the largest emerging markets region in the world and home to some of the fastest growing economies globally. In fact, more than 50 percent of the world's population lives in Asia providing the region with a huge consumer base.

One of the key supporting factors for investing in Asia is its robust economic growth. Asian economies have not only been growing faster than developed countries in North America, Western Europe, Japan, Australia and New Zealand but also their emerging markets counterparts.

Over the last ten years, Emerging Asia has recorded an average annual growth of 7.3 percent, compared to 2.7 percent for developed markets and 5.8 percent for global emerging markets.

Moreover, economists expect this growth trend to continue for the foreseeable future. Emerging Asia is expected to grow 8.8 percent this year, more than triple the developed markets' 2.5 percent forecast. And in line with that, the earnings growth in Emerging Asia is expected to be much stronger than that in the developed world.

Asia's economic growth has also been supported by the region's export growth momentum and more recently by growing consumer demand.

In addition, dependence on the U.S. as an export outlet has been decreasing in the region. Japan and China's role as outlets for exports from the rest of Asia also needs to be underlined. In addition, lower labor costs allow Asian markets to undertake competitive pricing to boost exports.

Fundamentals Remain Intact

One of the main investment themes in Asia is increasing consumption.

As a result of increasing per capita incomes and relatively young population structures, Asian economies are increasing domestic consumption of a wide range of goods. For example, in India and China, the number of cellular phone subscribers per 100 people in 2006 was 13 and 35, respectively.

While in developed markets such as the UK and U.S., it was 117 and 77, respectively. Thus, the potential for growth is enormous, with this growing demand expected to further boost domestic consumption and industrial output, leading to greater corporate earnings in the region.

Commodities have also been an important driver in Asia, given the increased demand from Asian industries. This growing demand is expected to further boost domestic consumption and industrial output.

Additionally, we'll see countries in Asia converging more and more as they increase trade with each other. We see this growth in the trade that Taiwan and Korea are experiencing with China.

Moreover, companies with good corporate governance can be expected to attract greater investor interest. As a result of corporate scandals in the U.S. and other developed markets, Asian markets are no longer perceived in such a poor light compared to developed markets in this regard.

More importantly, global investors' heightened awareness of corporate governance, has forced Asian companies to improve their standards. While some improvement has been seen, there is still a lot to be done and we expect to see continued progress in the future.

My advice to emerging market investors would be not to panic for recent volatility. It is very easy for us to be caught up in emotions or simply follow the herd.

I would suggest that investors take a long-term view to investing and carefully evaluate their options. History has shown us that the best time to buy is when everyone is despondently selling. This enables us to pick up stocks at more attractive prices.

The best strategy would be to remain diversified rather than pick one or two countries in the emerging market universe, since it would be difficult to know which market will outperform.

Thus, maintaining a diversified portfolio will allow an investor to better manage his/her risk levels. Also, value is the key. The best protection is to select companies that are selling at a discount to what they are really worth and companies with good managements capable of realizing the firm's intrinsic value.

Templeton's value investing strategy serves our investors well in these times of volatility as we invest in undervalued opportunities and adhere strictly to our value philosophy. Our investment strategy is focused, determined and constant. It is founded on value, patience and fundamental research.

Companies are evaluated on a five-year investment horizon with a focus on long-term potential, and not on short-term fluctuations. This also means that we do not "chase" stocks; rather, we allow undervalued securities time to appreciate as they gain recognition by the market.

The markets may continue to be volatile at times, but the underlying fundamentals of emerging markets remain intact.

Real Estate Bubble: Real and Imaginary

Bubble Essential Part of Market Economy

By Mauro F. Guillen
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Characteristically, they are based on assumptions that at some point turn out to be unrealistically optimistic or otherwise at odds with a supposedly "hard" reality.

When a bubble finally bursts, people always ask two questions. First, why did it last so long? And second, why are the effects so severe?

Obviously, the two are related to one another.

Of all bubbles, those involving real estate have the potential of lasting for a long time and having devastating effects.

The reasons are that people tend to be extraordinarily optimistic about real estate prices, they tend to participate in the creation of the bubble with borrowed money, and when the first signs of trouble appear, it is always easy for new buyers to wait and see, thanks to the existence of a relatively well-functioning rental market.

Much has been written recently about the existence of real estate bubbles in several European, Asian and North American markets.

Central banks, governments, international agencies, lenders and mere observers have pointed out that the combination of several years of hefty price increases and tighter credit conditions as of recent might bring about a self-reinforcing spiral of decline in real estate prices. While I do not wish to ignore the signs of trouble ahead, it is important to put things in perspective.

The market for real estate is a peculiar one.

People buy real estate because they need a place to live or to vacation. They also buy it as a store of value or, yes, to speculate.

Moreover, in some economies, the real estate sector has come to play a very important macroeconomic role.

Cheap credit guaranteed by real estate has made it possible for people to leverage themselves as investors or as consumers.

In the United States, the ongoing subprime crisis is scary because so much economic activity is driven by consumption itself fueled by borrowing against real estate assets.

As a recent study by the International Monetary Fund states, one should only be concerned about rising real estate prices when incomes do not grow at the same pace.

Between 1999 and 2006 real estate prices in the U.S. rose by about 6 percent annually. Incomes rose by just about 2 percent annually over the same period.

Given that foreign purchasers of U.S. real estate account for only a tiny fraction of all transactions, the trend cannot be sustained, especially now that credit is not as cheap as a few years ago.

In most East Asian countries, by contrast, incomes have grown faster than real estate prices.

For instance, over the same time period, China saw an annual hike of 2.6 percent in real estate and a whopping 9.5 percent in incomes.

In South Korea, the corresponding figures were 2.2 and 3.7 percent.

True, during 2006 prices went up by 12 percent, and by as much as 20 percent in the Seoul area. Based on this figures, The Economist magazine declared that the fear of a real estate bubble in much of Asia is exaggerated.

Reasonable people may look at the same set of figures and reach different conclusions, depending on their assumptions about future trends and events and on their attitude towards risk.

I believe that in a country like South Korea the most serious risk right now is not so much that there might be a correction in real estate prices but rather that the government and key economic agencies might overreact to the threat.

Although inflation remains low, the Bank of Korea seems to be inclined to raise interest rates at the first sign of trouble. Such a move would increase payments on existing loans and depress asset prices. As a side effect, it might reduce consumption enough to affect the rate of GDP growth. At a time when the South Korean economy is growing more slowly than it used to, the central bank needs to carefully weigh the consequences of its actions.

Governments, including the South Korean one, can also change regulations, especially taxes, in order to ensure a soft landing of real estate prices.

An important factor to keep in mind when designing such regulatory changes is to aim at the right target.

Changes in taxes or real estate rules should not discourage first-time homebuyers; they should target speculators. But they should be carefully calibrated so that even speculators in real estate have a way out. Eradicating speculation in the short run causes a bubble market to crash. The change has to be gradual so that all actors involved can adjust.

Perhaps the most important role the government can play in the middle of a real-estate bubble is to ensure that banks are making the appropriate provisions to protect themselves against the potential negative impact of non-performing loans.

As long as profits during good times are set aside to cover losses during bad ones, the financial system will remain a solid pillar of economic growth. This should be the utmost priority. Hence, governments and government agencies need to carefully assess the combination of measures — monetary, regulatory and others — that facilitate the smooth development of markets, including the market for real estate.