Hasenstab: Standing One’s Ground

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When the masses are against you, it’s hard to stand your ground. Going against the crowd is familiar turf for Michael Hasenstab, who manages Templeton Global Bond Fund and co-manages Templeton Global Balanced Fund, and certainly knows the virtue of patience. He has staunchly defended his investment theses over the years, tuning out the naysayers and market noise time and again. Ireland, a country that only a few short years ago, few investors wanted to touch, is a case in point. It’s become one of the biggest turnaround stories emerging from Europe’s debt crisis. Hasenstab continues to stress the importance of taking a long-term view and standing your ground, and says investors should exercise patience not only in other parts of Europe today, but also in select emerging markets, including China.

We’re very excited about the investment possibilities ahead in 2014, and are generally optimistic about many parts of the world. As I have been travelling and conducting research in Asia, I thought it was worth highlighting some of the things that excite us about the region, for example in China. We think China is on the cusp of some major financial market reforms that, ultimately, could reshape its economy and financial landscape in the next decade. We think the success of those reforms could provide a more sustainable growth pattern for China’s economy, so we are excited. In the short term, the environment is likely to be volatile, but long-term, we think the changes going on in China are exciting and will spread throughout the region. It’s important to be patient, and take a long-term view as China transforms.

Monetary Policy as a Currency Driver

Some of the opportunities we see in 2014, first and foremost, would be in active currency management. We think some of the major global monetary policy initiatives and changes, including the US Federal Reserve’s tapering of its asset purchase program, the continuation of Japan's massive money printing regime, and the likelihood of Europe maintaining fairly easy policy, could lead to fairly large changes in exchange rates. As the Fed begins pulling back on its asset purchases, we see the US dollar likely to appreciate versus the euro and versus the yen. But, as the US economy improves, we also think it could create better opportunities in select emerging markets. There's been some pessimism surrounding emerging markets overall recently, but the reality is there's a lot of divergence in emerging markets. For example, in 2013, Hungary's bond market was one of the best-performing markets, up over 10%[1], whereas South Africa's bond market was down close to 20%[2]. That variance is significant, and we think this year, it will likewise be important to be selective as investors. We think there are a number of countries, including Mexico and South Korea, that offer opportunities. In Asia broadly, we see a lot of bearishness even in places like South Korea, which we think is moving up the value-added chain in terms of export competitiveness and is supported by a current account surplus, robust economic growth rates and an interest rate advantage. We think Korea represents another place where patience is needed, with a long-term investment horizon, similar to Ireland.

That said, we also think there are parts of the world that one should be fairly concerned about.

Patience vs. Panic

Ireland is a good example of what we think we do best: identify opportunities in periods of panic when everyone is selling, and then step in and take advantage of that panic. We did it in Ireland; we've done it in Hungary. We have oftentimes done it throughout the world. Ireland recently exited the troika and has now re-accessed the market. On January 7, Ireland's international issuance of 10-year government bonds was met with over US$20 billion of demand on one single day. This just goes to show how things can change. We took advantage of the panic we saw in Ireland in 2011. When no one was buying, we stepped in. Now the world is interested in Ireland again, and to us, it proves having patience can be rewarded. Hopefully, Ireland's story will be repeated in many parts of the world that are struggling today. Even though the stories will be different, we plan to continue stepping in when other people are panicking. That's really the heart and soul of what our strategy is about.

Eurozone Armageddon Fears Fade

Our view of the Eurozone for quite some time has been that Armageddon wouldn’t happen. Sure, the Eurozone is very troubled, there are a lot of policy complications and there is a lack of coordination. However, at the end of the day, we felt the European Central Bank (ECB) would print a tremendous amount of money to prevent Armageddon. And that still is our central scenario.

Going forward, we think growth is most likely to be very weak in the Eurozone, and the ECB will most likely continue to be incredibly accommodative. As a result, the euro probably will weaken against the US dollar. We think the opportunity in Europe, though, is really on the periphery. Countries like Hungary and Poland, which have competitive labor markets, low taxes, good growth rates and are tied to the German export machine, present a lot of investment opportunities to us. These countries look more exciting to us than some parts of core Europe that we think will be fairly problematic for some time. We don’t think that the Eurozone will be a strong growth engine, but we also don’t think it’s going to be the Armageddon that some people had feared a number of years ago.

In today’s environment, we don’t think it makes sense to take a lot of interest rate risk, but it does make sense to take some currency risk. We believe an unconstrained, global approach allows us to exploit those opportunities in a way that can deliver some interesting opportunities to investors in 2014 and beyond.

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What are the Risks?

Templeton Global Bond Fund

All investments involve risks, including possible loss of principal. Currency rates may fluctuate significantly over short periods of time, and can reduce returns. Derivatives, including currency management strategies, involve costs and can create economic leverage in the portfolio which may result in significant volatility and cause the fund to participate in losses (as well as enable gains) on an amount that exceeds the fund’s initial investment. The fund may not achieve the anticipated benefits, and may realize losses when a counterparty fails to perform as promised. Foreign securities involve special risks, including currency fluctuations and economic and political uncertainties. Investments in emerging markets involve heightened risks related to the same factors, in addition to those associated with these markets' smaller size and lesser liquidity. Investments in lower-rated bonds include higher risk of default and loss of principal. Changes in interest rates will affect the value of the fund's portfolio and its share price and yield. Bond prices generally move in the opposite direction of interest rates. As the prices of bonds in the fund adjust to a rise in interest rates, the fund's share price may decline. The fund is also non-diversified, which involves the risk of greater price fluctuation than a more diversified portfolio. Changes in the financial strength of a bond issuer or in a bond's credit rating may affect its value. These and other risk considerations are described in the Templeton Global Bond Fund's prospectus.

Templeton Global Balanced Fund

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