EQUITY

Global Equity Outlook: Clouded by Uncertainty

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Global equity investors generally had reason to cheer in 2013, and seemed more willing to embrace risk as the year progressed. Will the bullish mood persist in 2014? Norm Boersma, Chief Investment Officer, Templeton Global Equity Group, says that while it's clear global investors have been allocating more dollars toward equities in recent days (particularly US equities), there are still a number of unknowns that make it hard to be overly exuberant.

In our view, the investment outlook for 2014 is clouded by uncertainty. By year-end 2013, global stocks had generally rebounded strongly off crisis-era lows, and many indexes were near record highs. Corporate profit margins in the US, the world's largest economy, were near peak levels, and US equity valuations appeared to us to be pricing in optimism at a time when politics are highly fractious and monetary stimulus will soon be tapered. Europe has continued to flirt with deflation, while China and Japan embark on very different, but equally experimental, reform paths with unknowable consequences. While investor sentiment has admittedly improved and equity inflows have been slowly picking up, this continued backdrop of macroeconomic and political uncertainty has kept enthusiasm in check. Consequently, investor skepticism has continued to create what we believe are selective opportunities at the bottom-up level, particularly in Europe, where we believe valuations and the corporate profit cycle remain clearly depressed. Overall, we think equities remain cheap relative to other asset classes as of December 2013 and an attractive source of yield potential in a low interest-rate environment. We believe net global policy conditions remain supportive, with excess liquidity still rising and Fed tapering appearing likely offset by the Bank of Japan's promise to double the size of its balance sheet. While we claim no ability to forecast the market and are aware equities have enjoyed a prolonged rally without a significant correction, in our view conditions do not evoke the euphoria normally associated with bull-market endings. Historically, sustained recoveries have tended to follow extreme contractions, making the current environment not as unusual as it may now seem to many observers. At the sector level, we remain positive on financials, particularly those in Europe. Political and economic concerns in the region have allowed us to own what we believe are fundamentally improving franchises with strong competitive positions at sensible valuations. In addition to deeper value banks in lagging eurozone economies, a diverse array of banks in northern Europe are among those we remain constructive on because we believe they have the potential to benefit from healthier domestic fundamentals and exposure to attractive markets abroad. Overall, we continue to favor European banks as a more robust regulatory framework and significant restructuring initiatives could help these franchises stabilize against a backdrop of gradual economic recovery. We also continue to find value potential in the energy sector. Like financials, energy represents a formerly high-flying cyclical sector that has lagged since the global financial crisis, creating what we believe to be value opportunities for disciplined investors. In particular, we have found increasingly compelling value potential in oil services, particularly those companies exposed to the shale revolution in North America. As ever, we believe investors should remain cautious and skeptical, with a focus on identifying where macroeconomic pressures are unjustly punishing businesses with improving fundamentals and favorable long-term earnings, cash flow and asset-growth prospects. We continue to look for such opportunities in markets and sectors around the world, and we remain positive about the long-term potential of our portfolios regardless of the market's near-term trajectory. For timely investing tidbits, follow us on Twitter @FTI_US and on LinkedIn. **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. Value securities may not increase in price as anticipated or may decline further in value. The risks of foreign securities include currency fluctuations and political uncertainty. Current political uncertainty surrounding the European Union (EU) and its membership may increase market volatility. The financial instability of some countries in the EU, including Greece, Italy and Spain, together with the risk of that impacting other more stable countries may increase the economic risk of investing in companies in Europe.
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