EQUITY

A Year for Value?

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While global equities appear vulnerable to near-term volatility, Templeton Global Equity Group's Norm Boersma and Cindy Sweeting are optimistic about the year ahead. And, they believe the environment appears favorable for value investing to shine. Read on for the team's 2016 outlook.

As 2015 comes to a close, some concerns about the global economy remain. Chinese growth continues to slow, keeping pressure on commodity prices and sending deflationary impulses throughout the global economy. Growth patterns in both the United States and Europe in 2015, while positive, hardly inspired enthusiasm, in our assessment. Japan's unbridled stimulus measures have yet to engineer a definitive rebound. High debt-to-GDP (gross domestic product) ratios persisted globally, cracks appeared in corporate credit markets and geopolitical issues created a continued backdrop of uncertainty.

Fundamentals Look Supportive to Value Investors

While stocks are certainly vulnerable to near-term volatility, we think the asset class globally remains well positioned for long-term performance potential. Within equities, value-oriented stocks remain particularly attractive, in our view. Looking at the historical performance of the MSCI World Value and Growth Indexes, value has lagged growth in recent years but has tended to recover strongly in the aftermath of past periods of sustained weakness.[1] We expect the eventual normalization of economic and policy trends to be supportive of value-oriented equities after this pronounced period of underperformance.

Looking at opportunities across regions, we remain positive on Europe, where policy remains supportive and corporate and economic fundamentals are improving. We believe the disconnect between depressed sentiment and more resilient fundamentals offers attractive buying opportunities. While we continue to find selective value in the dynamic US corporate sector, many US companies have broadly high valuations and extended profit margins, which makes our search for value challenging. We remain cautious and selective in Japan, where our main concern is that reform could stop shy of the real structural changes needed for corporate Japan to gain competitiveness, improve profitability, and overcome the country's daunting debt and demographic challenges. Emerging markets offer selectively better value to us after sustained underperformance.

Sector Views

Turning to sectors, we continue to find abundant value among energy producers and their services partners, and we believe the price of oil will likely recover toward the marginal cost of production as supply and demand adjust. In health care, major pharmaceutical firms have shown improved performance, making continued pipeline development essential to future return prospects. Elsewhere in the sector, we favor lowly valued biotech firms with innovative pipelines offering products with limited competition or demonstrable advantages over existing therapies. European financials continue to look attractive to us, as many have restructured and recapitalized and have been benefiting from improving credit conditions. Asia offers select opportunities in some mature banking markets like South Korea and Singapore and in underpenetrated growth-oriented markets like India. Opportunities, in our view, can also be found among a diverse range of asset managers, insurers, universal banks and bourses in the developed world.

As always, our focus remains on seeking to exploit the market’s short-term mindset and to buy businesses trading at a substantial discount to our assessment of their long-term intrinsic value. Our team of experienced global sector analysts and portfolio managers scour the globe for opportunities presented by an uncertain environment, attempting to use near-term pessimism to our advantage, with the goal of maximizing total absolute returns over time for our clients. While this approach to investing can be challenging at times when we find ourselves on the wrong side of market trends, our confidence in its efficacy over a long-term investment horizon is unwavering. By seeking out overlooked value potential in 2016, we will continue to build differentiated portfolios that we believe offer significant potential for long-term value recognition.

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1. The MSCI World Value Index is a free float-adjusted market capitalization-weighted index that is designed to measure the performance of value-oriented equity securities of global developed markets. The index is constructed by using price/book value ratios to divide the MSCI World Index into value and growth. All underlying securities with low price/book value ratios are classified as value. The MSCI World Growth Index is a free float-adjusted market capitalization-weighted index that is designed to measure the performance of growth-oriented equity securities of global developed markets. The index is constructed by using price/book value ratios to divide the MSCI World Index into value and growth. All underlying securities with high price/book value ratios are classified as growth. Indexes are unmanaged, and one cannot invest directly in an index. They do not reflect any fees, expenses or sales charges. Past performance does not guarantee future results.

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