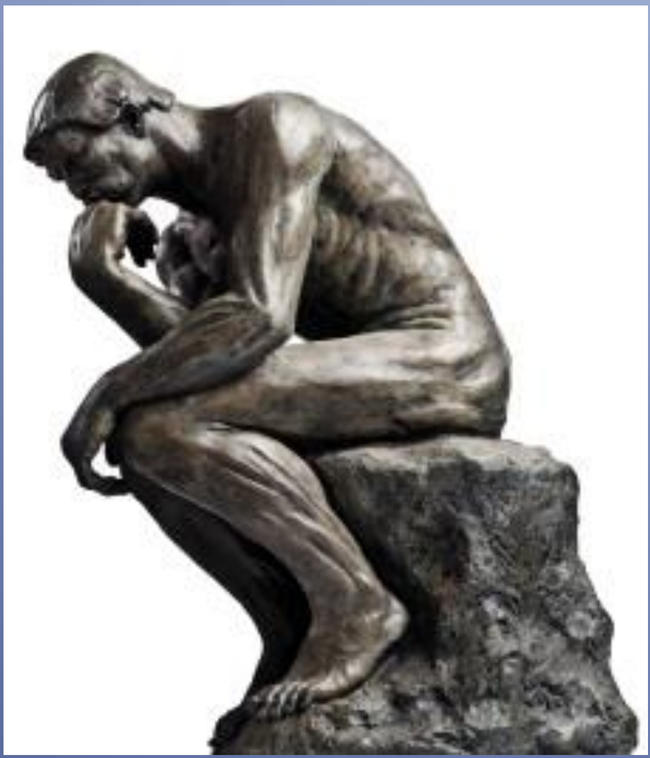


Fund Bites

Templeton Global Bond Strategies

This fund bite is an update on recent market volatility from Templeton.

Introduction

Recent market volatility has been driven by what is seen as indiscriminate selling based on short term fears with little regard of the underlying fundamentals.

Interestingly I recently read an article from Dr Doom who has predicted a number of "crashes" and "upturns" in the market, and he has indicated that he feels the market has oversold in recent weeks. Therefore his feeling is that once the market accepts this then there will be a reverse.

Whether this is correct or not it is important to focus on the underlying fundamentals. In 2008 / 2009 the underlying fundamentals were poor, the world had been built on sand and when the buildings started to collapse there were no foundations to hold them up were.

This time the fundamentals are different. The conference call we had was with Michael Hasenstab who is the Senior Vice President, Portfolio Manager and Co-Director of Templeton International Bond Department and Fixed Income Group.

This review looks at these fundamentals.

The Fund

In his view there are two types of risk, one where there is a permanent loss of capital so for example where interest rates move structurally higher and then there is market risk where there is short term panic in the market causing a spike in volatility. It is the later that the markets are experiencing and therefore the current volatility presents opportunities.

There are three key drivers, the US, Japan and China.

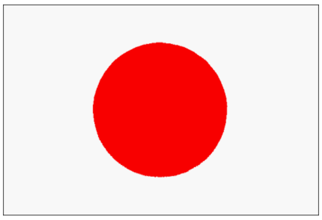
If we look at the US the printing of money could not go on for ever and therefore an end must come. This isn't immediate and is gradual as will an increase in interest rates. This doesn't mean the flow of liquidity suddenly ends. There will still be liquidity coming into the market but there will be less of it.

If we ask why this is happening then the answer is simple, the economic situation in the US is improving and therefore an improved US economy is good for the global markets.

The assumption is that this drying up of liquidity is a life blood for emerging economies. However emerging economies do not rely on this in the same way that they did 20 years ago. In fact most economies have current accounts in balance, their debts are low and they have reserves.

Mexico as an example has three times coverage of recent inflows. This level of solvency and lack of reliance on easy money points to this volatility being more temporary than permanent.

In summary the fear of tapering is being overstated in the emerging economies which have better growth dynamics, inflation and higher interest rates.



Currently the US is pumping around $1 trillion of money, as US switches this off Japan is beginning to ramp and is printing around 10% money a year (again around $1 trillion). So as one goes another comes in. In Japan this is a long term strategy with the aim to end deflation.

Japan's strategy has only just started and until structural changes happen and the economy starts to turn the strategy will continue, this is not short term and could be several years.

Turning to China, China is reacting the same way that they reacted to the housing bubble. They are reigning in the shadow banking system. The sector is too hot and they are correcting a potential problem before it happens. By squeezing liquidity they are causing short term pain but it is better to do this now rather than letting it explode.

It is also an indication of the final major reform which is of the financial system which will eventually lead to the liberalisation of interest rates. This will take years but has to start.

Looking at the economy it will have lower growth rates but we need to consider that China's growth market is twice as big as it was ten years ago and that will increase significantly. Effectively you will have lower growth but greater demand, before you had higher growth and lower demand – the two counterbalance each other.

Conclusion

The conclusion is that the fundamentals remain, the US is moving to a growth phase and will taper QE and increase interest rates, as the US does this Japan will be ramping up QE in a drive to move away from deflation and China is moving into the next phase of becoming a mature economy.

As for emerging markets as we have indicated before not all markets are the same – if you use a tracker fund to play the market you will get burnt. There are economies where there are concerns so the likes of Brazil and Turkey but the likes of Poland, Mexico and Korea offer excellent opportunities.