GROWING WITH THE GLOBE

In his 20th year at Franklin Templeton, portfolio manager Peter Wilmshurst faces the challenge of delivering stable returns in an increasingly volatile global political and economic climate. He talks to **Alex Burke** about the future of the firm's longstanding listed investment company, the Templeton Global Growth Fund.

If there's one particular theme Peter Wilmshurst likes to emphasise when describing his investment philosophy, it's patience.

This can be a bitter pill to swallow for a certain type of investor, given the market anomalies widely covered in the press over the past decade – rapid growth in tech companies, digital disruption of traditional industries, the impending "crypto bubble" and so on – but it's an approach that has paid dividends (literally) for shareholders in the Templeton Global Growth Fund (TGG), which first listed on the ASX in 1987.

Wilmshurst joined Franklin Templeton in 1997, having previously been a research analyst and portfolio manager in the Australian equity team at Norwich Investment Management. Prior to that, he was an actuary with MLC Life.

In his current role, which extends to serving as an executive vice president in the Templeton Global Equity Group and an analyst covering banks in the EMEA region and Asian telecommunications companies, Wilmshurst aims to invest in a diversified portfolio of global securities irrespective of benchmark weightings to particular regions or sectors. It's a value-driven, bottom-up process that he admits hasn't exactly been in favour over the past few years.

"Value's had a tough time of it recently," he says.

"There are many factors that should have helped, but 2017 was definitely a surprise, because some of the things that you'd typically see working in its favour haven't happened."

He's pointing to an inconsistent set of growth trends: while the global economy is improving, and the Federal Reserve looks to be on a general upward track vis a vis interest rates, the European Central Bank and the Bank of Japan are still operating at historical lows.

"Historically," he adds, "value's done better when rates are going up and when the economy's doing better. Both of those should have been good, but they haven't been quite as good as we'd thought."

This idea was expanded upon in TGG's quarterly investment update, which also served as an overview for 2017 as a whole. Wilmshurst pointed to a "false dawn" in 2016, after which "value lagged growth by the most in nearly two decades in 2017, marking the 10th year out of the past 11 that global growth has bested global value."

"At times like this it may be tempting for some value investors to relax their discipline and buy the expensive stocks that have been working," his letter read.

"Yet countering that impulse is decades of market history, suggesting that starting-point valuations are virtually all that really matters when it comes to long-term results. Meanwhile, financial repression from the world's central banks appears to have forced investors farther out the risk spectrum to chase yield and growth in a market offering little of either."

This, he added, was unsustainable for two key reasons: first, a large portion of the general public has come to see zero interest-rate policies, along with quantitative easing, "to many consider zero interest-rate policies and quantitative easing to have favoured capital at the expense of labour, deepening inequality and disadvantaging the majority of the electorate, whose opinions matter in a democracy."

The second issue is that "financial repression" has the potential to fuel destabilising asset price bubbles. At this point, he said this overvaluation is largely concentrated in fixed income markets and growth-oriented bond proxy stocks dominating the current market cycle.

"We do not know how the process of policy normalisation by central banks will evolve," he said. "Nonetheless, we do believe this mature cycle will eventually change, and with it the conditions that have been so hostile to value investing.

"We would not want to own the leaders of the last cycle during this transition. But the stocks left behind – the companies whose long-term earnings and cash flow potential we believe have been overlooked and undervalued by a narrowly-focused market – might be best positioned for the reversals we view as likely to unfold in the future."

This is why Wilmshurst advocates a balanced approach. Pointing to the "bond proxies" mentioned in the TGG investor letter, he notes that his portfolio is "severely underweight" to consumer staples relative to the MSCI All Country World Index, because he sees many of those stocks as being overvalued as a result of their "safe harbor status."

"If people are concerned about what's going on in the world," he says, "Nestle and Unilever make them feel safe. Take your standard Swiss life insurance company – government bonds are going negative, so why lead it on a bond where you know you're going to get a negative return? You probably don't want to buy UBS or Credit Suisse because it's too risky for that kind of portfolio, but you could buy Nestle."

It's a similar case in US equity markets. Despite the dominance of US equities in both the benchmark and global equity portfolios, he says that value opportunities still exist, but largely outside of the industry sectors that represent a sizeable portion of the S&P 500.

"We actually do own some of the big guys in the US," he explains, adding that TGG's modelling typically puts the US banks historically trading at 1.4 times their book value over the past century.

"During the GFC it went below that," he continues, "but you still have some trading around tangible book value, which is why we still own Citigroup. We still own J.P. Morgan, which is at a big premium but we bought it when it was around book value. We own Asian financials as well - I haven't actually done the numbers, but financials is probably one of the most globally diversified of our sectors."

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> **Peter Wilmshurst**

This applies to the Eurozone as well. Wilmshurst concedes that the (unlikely) event of a breakup would "destroy" many companies operating in the region, but argues this is why being truly globally diversified is so important.

"Even in 2012," he explains, "we went out and bought some Greek banks. They were in trouble, and would be in serious trouble in the event of a Eurozone breakup, but that's why we have a less concentrated portfolio. If you're buying Nestle or one of those guys you can have a more concentrated position, but if you're buying a French bank with a subsidiary in Greece, you buy an Italian bank as well."

Ultimately, it comes down to diversification and patience. At certain points, this balanced and patient bottom-up approach actually brings the portfolio closer to the weightings in the benchmark, "but usually the answer is somewhere in between."

"Sometimes the revenue exposure can be pretty close," he says, "but that's a coincidence given that we're completely bottom-up. Looking forward, we're just going to continue thinking about which industries are going to develop – whether it's autos or pharma or whatever – and then get to know the companies, talk to them and work out the next opportunity to find true value." **FS**