FRANKLIN TEMPLETON INVESTMENTS

BEYOND BULLS & BEARS

PERSPECTIVE

Three Words for Brazil

October 31, 2014

Mark Mobius
Executive Chairman
Templeton Emerging Markets Group

As long-time investors in Brazil, the recent presidential election has been of keen interest to us. One can certainly say it's been an interesting race! The market had been volatile based on the changing polls leading up to the election; there were hopes that new leadership would ignite a positive new direction for Brazil's economy, which hasn't experienced the type of economic boom many (including us) had hoped for—and believe is possible. After a particularly close race, incumbent Dilma Rousseff emerged victorious and Brazil's stock market, at least initially, didn't seem to like the result. This isn't really a surprise, as many investors, frustrated with the direction of the economy and the business climate there, were clamoring for change. We hope that Rousseff can now follow through and deliver positive changes, not just promises.

Seemingly recognizing the stock market's potentially negative reaction, in her post-election speech Rousseff stated that one of her first tasks would be to overhaul the political system, with the intent to reduce corruption. She also pledged to engage in a more open dialog with her critics. Heavy bureaucracy and alleged cases of corruption (particularly among state-owned companies) are big problems that we think warrant attention. The bottom line, as reflected in the debate leading up to the election and the particularly close result—Rousseff received just over 51% of the vote—is that people want change. In our view, the degree of inefficiency and lack of progress with regard to reform is holding back investors and the country in general. Although we see some positive longer-term trends, recent macroeconomic indicators appear generally weak.

The unemployment rate is low, but that's tied in part to shrinking labor forces; job creation has deteriorated due to losses in construction, manufacturing and transportation sectors. Industrial output was down over the summer, stalled in part by the World Cup events as many workers, and host cities, took holidays. While tourism swelled, the event came with a high price tag, and it remains to be seen if significant long-term structural or economic benefits will result.

Brazil is currently flirting with recession, as gross domestic product (GDP) shrank in the first and second quarters of this year. Real GDP growth (adjusted for inflation) in Brazil is expected to rise a mere 0.3% in 2014, while consumer price inflation is expected to rise an uncomfortable 6.3%.[1] I don't think you can blame Brazil's poor fundamentals solely on outside market influences. Brazil's economy is huge—the 7th largest in the world by GDP.[2] Brazil has the resources and the people to do better from a domestic standpoint, regardless of the issues in the global economy, in our view.

As investors, we certainly pay attention to the overall political and macroeconomic environment, but we don't base all of our investment decisions on these areas either. We remain investors in Brazil and plan to continue searching for potential opportunities there on a stock-by-stock basis. We have seen, for example, Brazilian banks show resilience during hard times, so that's an area we are watching. Consumer spending is a big question mark right now, as spending power is down. If Brazil's market continues to correct, we will be searching for potential bargains there, in companies we think can survive and, hopefully, thrive in spite of the broader political or macroeconomic environment. We would note that often the most unpromising short-term situations can potentially deliver the greatest long-term investment outcomes, as bad news can become overly discounted.

We also believe Brazil's exceptional endowment of natural resources, including both industrial and agricultural commodities, could have rising long-term value in an industrializing, urbanizing and increasingly wealthy world, while a growing body of middle-class consumers in Latin America at large could represent a substantial additional source of longer-term growth in demand.

In our view, a more market-driven economic approach in Brazil, together with a reduction in bureaucracy, should benefit both the people of Brazil and investors in the country, but our investment metrics suggest that a number of businesses with strong management and attractive positions in their markets are well placed potentially to prosper even in a business-as-usual environment.

We still remain optimistic that Brazil can reach its full potential with these three words: reform, reform, reform!

Dr. Mobius's comments, opinions and analyses are his personal views and are intended to be for informational purposes and general interest only and should not be construed as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy. It does not constitute legal or tax advice. The information provided in this material is rendered as at publication date and may change without notice and it is not intended as a complete analysis of every material fact regarding any country, region market or investment.

Data from third party sources may have been used in the preparation of this material and Franklin Templeton Investments ("FTI") has not independently verified, validated or audited such data. FTI accepts no liability whatsoever for any loss arising from use of this information and reliance upon the comments opinions and analyses in the material is at the sole discretion of the user. Products, services and information may not be available in all jurisdictions and are offered by FTI affiliates and/or their distributors as local laws and regulation permits. Please consult your own professional adviser for further information on availability of products and services in your jurisdiction.

What are the Risks?

All investments involve risks, including possible loss of principal. Foreign securities involve special risks, including currency fluctuations and economic and political uncertainties. Investments in emerging markets, of which frontier markets are a subset, involve heightened risks related to the same factors, in addition to those associated with these markets' smaller size, lesser liquidity and lack of established legal, political, business and social frameworks to support securities markets. Because these frameworks are typically even less developed in frontier markets, as well as various factors including the increased potential for extreme price volatility, illiquidity, trade barriers and exchange controls, the risks associated with emerging markets are magnified in frontier markets.

---

1. Source: IMF World Economic Outlook, October 2014. © by International Monetary Fund. All rights reserved.

2. Source: World Development Indicators database, World Bank, 22 September 2014.