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Cos with Growing Markets, Low Leverage to Outperform

Volatility will continue to be a driving force for the market in 2016, said **Stephen H Dover**, managing director and international chief investment officer - Franklin Local Asset Management, Franklin Templeton Investments. In an interview with **Biswajit Baruah**, Dover said in an environment of rising US rates and global uncertainty, companies that have low leverage, stable cash flows, strong brands, and growing demand for their products are likely to outperform the markets. Edited excerpts:

Do you think emerging markets including India will remain volatile in 2016, as expectations of further US interest rate hikes have increased?
We believe volatility will continue to be a driving force in the markets of 2016. In all likelihood, we could see an increase in divergence between the growth rates of different economies during the year, as any rise in US interest rates would have different consequences for various countries. We also expect a deepening divergence of global monetary policy, with US tightening countered by continuing accommodative policies in major markets.

What kind of companies are you looking to add in your portfolio in this challenging environment?
The leverage levels of many countries, as measured by their debt-to-GDP ratios, have not weakened significantly during the recent period of increased global liquidity resulting from accommodative monetary policy. Many Asian countries, in particular, are well positioned. At the company level, however, we have seen mismatches between US-dollar liabilities and cash flows in local currencies that have depreciated relative to the dollar. In an environment of rising US rates and global uncertainty, we believe companies with low leverage, stable cash flows, strong brands and growing markets for their products are likely to outperform some of their less stable peers.

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Companies with low leverage, stable cash flows, strong brands and growing markets may outperform less stable peers

Which are the global economies you expect to perform well in 2016, and do you think China slowdown will remain an overhang?
The IMF and the OECD have forecast improved growth for the global economy in 2016, with the proviso that growth is likely to be uneven across the main countries and regions. To a greater or lesser degree, expansion is expected in the advanced economies of North America, Europe and Asia, with the United States remaining the world's largest economy. While China's slowdown caused considerable concern in 2015, falling below its previous targets, we think the economy will continue to grow throughout 2016, albeit at a less blistering pace.

Do you think underperformance of Brazil and Russia can have adverse impact on other emerging markets like India as global emerging market funds continue to face redemption pressure?
The emerging markets are entering 2016 in a much weaker position. Some sizable developing economies, such as Russia and Brazil, will need to extricate themselves from recession. Reduced capital flows and currency pressures have affected the ability of some emerging countries to finance vital projects. In turn, weaker demand for commodities and finished goods is having far-reaching effects on advanced economies looking to increase their exports. Supply overhangs of base metals and fuels especially oil have led to lower commodity prices, to the point where producers in both developed and emerging markets have been shutting down facilities and laying off workers. The corollary, of course, is that commodity importers, which include a number of eurozone and Asian economies, have benefited from lower costs and greater security of supply.