

Global Equity Investing and Market Volatility in Australia



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Thinking about Investment Fundamentals

In June 2013, the

Aberdeen Asset Management's Global Equities Team wrote:

Arguably money printing – in the bluntest sense – by central banks was never going to solve the structural problems of the developed world. It has bolstered the banking sector, and provided support to the financial markets, but there is little evidence of this huge monetary experiment finding its way into the real economy to foster growth.

For Australian markets, the current theme of “having to navigate strong headwinds” for economic recovery continues to persist. Most experts agree that the strategies of Quantitative Easing (QE) and liquidity injection has helped, but only in part, and will not correct the structural issues (particularly European debt and the United States’ fiscal deficit problem) in a global economy.

The investment solution has always been there, but it bears repeating. Again from Aberdeen's Global Equities Team:

Overall, we remain comfortable with the companies in our portfolios, given the quality of management, balance sheet strengths, and business models. We have experienced periods of underperformance before and the



mistake would be to compromise our investment process and invest in poor quality companies merely to achieve short-term gains. Therefore, we will continue to focus on investing in companies that are financially strong, and can weather, and indeed grow in the weak global economic environment we foresee over the next few years.

My father worked as a self-employed, small town attorney for over 30 years. He did probate, mortgage, and prosecution as a majority of his legal work. He retired in 1989. As was the age, my mother was a homemaker who chased after 5 children. He once told me that he never earned more than \$35K in any single work year. Today ... at 86 years of age ... his portfolio is 7-figures and continues to grow even though he has been retired for 24 years, without

earned income.

So, in light of all the present-day economic questions and issues, how does a small-town attorney from the Midwestern part of the U.S. grow a million dollar portfolio from a limited income capacity?

Dad held similar fundamentals of investing throughout his working years. He invested in solid companies and would not be distracted by short-term blips. His investment success is also due to his rock-solid belief in the long-term power of positive balance sheets and selecting companies with strong fundamentals.

So what about the continued volatility in global markets, especially investing in equities? Let's take a closer look at the volatility issues as it relates to the Australian markets.

Reasons for Australia's Market Volatility

Australia has a strong trading relationship with China. Chinese investors believe that its GDP will slow down over the next few quarters, if not longer. This is a result of current uncertainties in the Chinese banking sector and recent retracement of some economic activity with China.

We have already discussed the second reason for volatility in Australia's equity markets. Because of the Fed's recently expressed interest in limiting QE, which will have an indirect impact on the Aussie dollar. There is a strong sense from asset managers, that the United States' potential cutback in the QE program will further depreciate the Australian dollar below the parity price of the U.S. dollar.

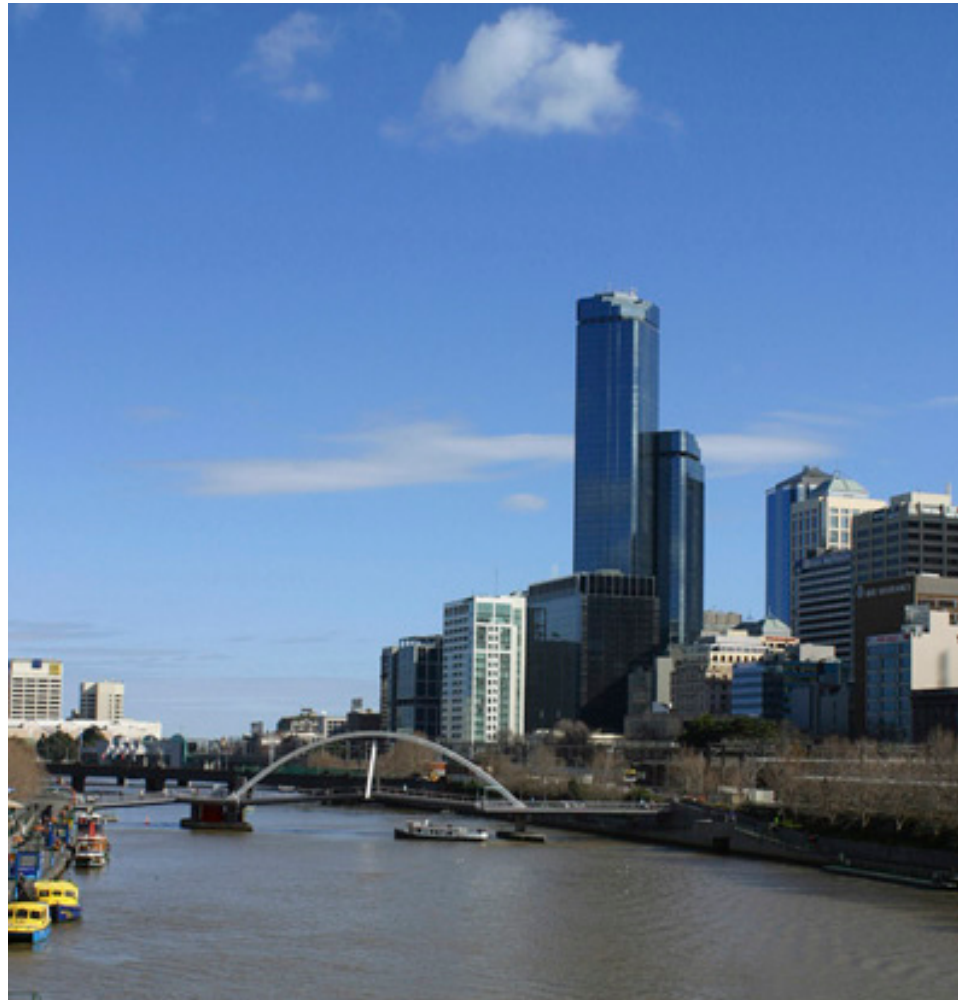
And, of course, there is always political sway. Approaching elections in Australia will weigh ambiguously on her equity markets. Campaign promises eventually lead to post-election impact. It leaves the Australian business sector confidence in a weakened state.

But despite all the issues that cause a backdrop of Australia's

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market volatility, there are many companies who continue to be vigilant in watching their balance sheets and cautious with their capital investments.

Before we highlight a couple of



equity fund examples that contain solid cores; let's explore a couple of the bigger "myths" about global equity investing:

- One of the biggest myths is that the current economy should direct your current investment strategies. The advantage of active asset management is the attentive pursuit of fundamentals. Blue Chip Stocks, by definition, are those companies that can grow no matter the domestic or global economic climates. They have demonstrated their ability to "weather many storms" and still provide investors with growth potential, especially through price appreciation.
- A second common myth is that you are only diversified

if you have a large number of portfolio stocks. Famous British economist John Maynard Keynes (Keynesian Economics) makes a perfect distinction about the theory of diversification:

To suppose that "safety-first" consists in having a small gamble in a large number of different [companies] where I have no information to reach a good judgment, as compared with a substantial stake in a company where the information is accurate, strikes me as a travesty of investment policy.

- Finally, a perpetually stubborn myth is that it's too risky to consider emerging markets for your portfolio. Actually most analysts are reporting that

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balance sheets in emerging economies have fared comparatively well as developed nations during the recent financial crisis. If companies in emerging market places turn to continuous improvement for their internal structures (debt thresholds, proactive business models, and capital investment) ... there are optimistic reasons for long-term growth potential.

In short, volatility can benefit the investor. For example, one lesser known option for investors is closed-end funds. What we particularly appreciate about closed-end funds is the management aspect.

Just like, open-ended funds, there are a variety of choices for the consumer, but unlike open-ended funds ... every closed-end fund is actively managed ... building on the promise of including companies that are structurally stable and well-managed. Here are two such closed-end funds that we have selected to highlight in this article:

Aberdeen Australia Fund (IAF)

Investment Objective: Its principal investment objective is long-term capital appreciation through investment primarily in equity securities of Australian companies listed on the Australian Stock Exchange Limited (ASX). The Fund's secondary investment objective is current income.

The Aberdeen Australia Fund (IAF) invests in 100% equities; 98.5% in Australian companies and 1.5% in United States companies. Sixty

percent of the portfolio is comprised of materials and financials.

Recently, the website Seeking Alpha[®](www.seekingalpha.com) touted the exploration of emerging market equities, by positing:

- Global dividend paying stocks are inexpensive and offer compelling yields for the investor
- Global dividend paying stocks offer solid diversification when taking into consideration currencies, interest rates and fiscal conditions
- These stocks should be capable of generating income and appreciation for years to come

The Aberdeen Australia Fund's recent performance is intriguing. In 2012, IAF's price increased by 28 percent and the NAV increased 22 percent, with the Year-To-Date price up 5.4 percent.

Aberdeen Emerging Market Smaller Company Opportunities Fund (ETF)

Devan Kaloo, Head of Aberdeen's Global Emerging Market Equities Team, recently wrote:

The fund was formally the Aberdeen Emerging Markets Telecommunications and Infrastructure Fund, but as of March 15, 2013, we received shareholder approval to restructure the fund into the Aberdeen Emerging Markets Smaller Company Opportunities Fund, Incorporated.

Essentially what we are looking to do with this fund is to invest

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in emerging markets smaller companies and we certainly believe there are some potential opportunities for the fund going forward.

With the current number of invested countries at about 23, the change the restructured fund provides investors with more countries than the original fund and is also exposed through 10 different sectors, with the heaviest weight in consumer staples.

Aberdeen is hedging that small cap companies with eye-catching business models and the need for capital in emerging markets will provide investors with a revitalized option in the next few years to come.

There is little doubt that current investors continue to be cautious about where to place their reserves, especially equity investments. Because Australia is a strongly developed nation, and provides entree to emerging Asian markets, especially China ... we really like the notion of emerging countries and their companies as a valid current investment strategy.

My 86-year-old father is probably already exploring his own global equity options.