Q&A-"Reluctant to invest" in Chinese ADRs post-regulatory crackdown; Bullish on India due to demographics & tech, services foundation: Lauren Templeton

China's regulatory crackdown on various sectors including technology and education has made **Templeton and Phillips Capital Management** "reluctant to invest" in any of its companies' exchange-listed American depository receipts, **Lauren Templeton, founder and president of the fund,** told the Reuters Global Markets Forum on Tuesday, August 3.

"There are very few protections for Western investors," she said, adding that her fund owned no Chinese companies, but had "exposure to the Chinese consumer through multinational companies," with Hong Kong-listed securities on their "watchlist."

Templeton said it was a "reasonable assumption" that funds would flow to other markets post China's regulatory crackdown.

Separately, Templeton said her fund was bullish on and invested in India. "We like the demographics, and we like the foundation of technology and services in the Indian economy."

Following are edited excerpts from the conversation:

Q: What is your view on U.S. equity markets, especially the S&P 500, and do you see a bubble there?

A: We certainly see extended valuations in a number of areas that do not appear sustainable in the years to come. For instance, we recently found over 700 stocks trading at over 20x sales in U.S. markets. Obviously, growth will need to come through or a large number of stocks are vulnerable to declines.

I learned a long time ago not to predict the market over the short term. It would not surprise me if a lot of the rebound has already been captured in share prices.

Q: What sectors do you think are more at-risk?

A: Technology and to some degree housing.

Q: How are positioning for these in your portfolio?

A: We have a slightly different view of the current environment. We note that in late 2019 there was record corporate debt at approximately 46% of GDP (gross domestic product) in the U.S. In the years leading up to COVID-19, we had emphasized quality, clean balance sheets, and self-funding growth at the company level. The NBER (National Bureau of Economic Research) recently reported that the COVID-19 recession of 2019 only lasted two months -- the shortest on record. With that said, the recession did not cleanse the system of excessive corporate debt. Instead, the Fed enabled $1.7 trillion of new debt on corporate balance sheets. We are still positioned for an eventual fallout from these excessive debt levels.

Q: What is your view on China and its tech crackdown? Do you see any risk emanating from this to U.S. equities?

A: We have been long-term proponents of the Chinese consumer and tech plays a role. For instance, we purchased Alibaba in mid-2015 and held it until May of 2020. What bothered us at the time, and still bothers us today, is that there are very few protections for Western investors -- property rights. Going forward, we still think the Chinese consumer will grow and develop. However, we are reluctant to invest in any exchange-listed ADRs (American depository receipts). We still have exposure to the Chinese consumer through multinational companies.

Q: So currently, you own no Chinese stocks?

A: Correct.

Q: Could you expand on what you would like to see as Western investor protection -- enough to re-enter the market?

A: We still feel relatively comfortable with Hong Kong-listed securities. Our concern of Chinese ADRs is its VIE (variable interest entity) legal structure, which amounts to a tracking stock.

Q: Are you already invested in HK-listed companies, or planning to increase exposure, if already there?

A: No, but HK listed companies are on our watch list.

Q: What other markets are you investing in?

A: We are invested in India and have been long-term bulls on India. We like the demographics, and we like the foundation of technology and services in the Indian economy.

Q: Do you see funds flowing to other markets, due to the China crackdown?

A: Yes. It is a reasonable assumption.

Q: What is your opinion on the global market outlook with regards to effects of the pandemic?

A: The pandemic is here to stay for the foreseeable future. With that said, economic activity will be choppy. Our view is that investors need to be careful with corporate balance sheets within this context because economic weakness could occur at any point. Likewise, these events will prompt further government spending deficits and the additional risk to sovereign debt balances, and therefore risk premiums.

Q: What's your stance on inflation -- transitory or persistent? And how are you positioning for that?

A: Inflation is being driven by policymakers. It depends on their willingness and ability to continue holding rates very low and running large deficits. Inflation will persist as long as these policies are in place. Likewise, there are no quick fixes to the supply chain issues helping to spur inflation.

Q: Do you see U.S. Federal Reserve's policy heading from here?

A: The Fed understands that it has to keep inflation expectations under control. Also, we see little ongoing reason for the Fed to continue supporting the housing market throughs MBSs (mortgage-backed securities) purchases. It makes sense for the Fed to begin tapering this activity.

Q: What is your take on cryptocurrencies? Have you invested in any of them?

A: No. Speculation! John Templeton said, "Invest. Don't trade or speculate."