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THE SCOTT LETTER is intended to educate global investors about closed-end funds. Closed-end funds can be a valuable and profitable investment tool. To learn about closed-end funds, visit our web site, www.CEFAdvisors.com, and in particular, read our article, What Are Closed-End Funds.

Feel free to forward this news-letter to anyone who you believe could benefit from information on closed-end funds or global portfolios.

– George Cole Scott, Editor-in-Chief

– John Cole Scott, Contributing Editor

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Mark Mobius: His Investment Philosophy, Trump, Putin, Globalization, Arctic Oil

Mark Mobius joined Franklin/Templeton in 1987. He is Executive Chairman of Templeton Emerging Market Group. He directs analysts based in 18 Templeton Emerging Markets offices and manages emerging markets portfolios.

Mobius has won many awards, incuding Morningstar's 1993 "Closed-End Fund Manager of the Year." This was the year that I met him, have stayed in touch, and have since interviewed him for *The Scott Letter*.

In 1992, Sir John Templeton agreed to merge his firm into Franklin Resources, Inc. which had decided to broaden their company line to increase the assets of a primarily fixed income portfolio into a global one.

After the deal was struck, and the merger went forward to merge with Templeton, Galbraith & Hansberger Ltd. (a firm owned primarily by Sir John Templeton, his son Dr. John Templeton and John Galbraith). Mobius was appointed to the Board at inception.

Dr. Mark Mobius

Mobius became the Managing Director of the Templeton Emerging Markets Fund (NYSE:EMF) with this transaction, and the new firm Franklin Templeton Investments (NYSE:BEN) acquired a strong portfolio of international funds and the expertise of emerging markets guru, Mark Mobius. That move proved highly beneficial to both firms.

In the summer of 2012 (the same year Vladimir Putin was elected Premier), I was lucky to be able to travel across the entire Russian continent.

I traveled with Russian-born Anatoly Mikutin, a long-time friend and physical therapist with a medical degree from Moscow. He joined me on a transcontinental rail trip in 2012 because I was not ready to travel across that large country without his extensive knowledge of it. We stopped along the way at Lake Baikal in Siberia and other cities while traveling to Vladivostok (Russia's only seaport on the Pacific Ocean).

Mikutin and I also traveled to the Hong Kong handover to China on July 1, 1997. While there, I introduced Anatoly to Mark Mobius who often asks me about him.

We interviewed Mark in December of 2016 while he was visiting the Philippines.

SL: Good morning, Mark. We are always interested in your current thoughts about the emerging markets and the wide investment universe that you cover which includes tens of thousands of companies in markets on nearly every continent. What are your thoughts on the negative criticism in the media about investing in the emerging markets that many investors think are slowing down?

Mobius: You have a very good point there. It is amazing if you think about it. You know everybody is worried about this interest rate business. The reality is, if you look at the last ten years, it doesn't make sense because the correlation between the interest rates in the past and the movement of the emerging markets is just not there.

SL: What are the best reasons to invest in the emerging markets?

Mobius: Because that's where the growth is. The economies of the emerging markets are growing much faster than those in the higher-income and developed countries. Since launching the Templeton Emerging Market Fund (NYSE:EMF), these markets have outperformed the U.S. markets by 940%.

[**Editor's Note:** Mobius adds that The International Monetary Fund estimated emerging economies were growing three times faster than the 2% growth estimated for developed countries. There are many risks, however, in investing in emerging markets, but they also provide new investment opportunities, such as elevated economic growth, while domestic investing can be risky if investors overlook diversification that helps reduce investment risks.]

SL: We notice that volatility as a characteristic of all markets – even the most mature ones. To take the edge off this volatility, we see that your strategy is to (1) search the world for the best investment bargains, (2) focus on the long-term, (3) use common sense, and (4) faithfully follow the time-honored, value-oriented and sometimes contrarian strategy first pioneered by Sir John Templeton.

We enjoy your frequent blogs; they help us to keep up with what you are doing. How large is your circulation?

Mobius: It is a way to reach investors who might want to venture into the emerging markets. A blog is just another medium. I can't reveal any hot picks due to strict legal and ethical considerations. There is no simple secret, no blueprint and no rigid road map that will guarantee you, me or anyone long-term successes as a global investor. With regards to circulation, go mobius.blog.franklintempleton.com.

We believe it is important for investors to take a long view and not be swayed by short-term volatility. Funds focused on stocks that look undervalued generally outpace growth strategies. Regarding the [world] stock markets, sometimes they go down together, sometimes they go up together and sometimes in opposite directions. The correlations are very low. The reality is it's not the emerging market equities but emerging markets income.

However, there is some room for concern. Money is still flowing out of China. A lot of it is going into mergers and acquisitions by Chinese companies that are acquiring assets overseas.

Trump and Putin

SL: What do you think about Donald Trump?

Mobius: Our new President is really a bargainer, a negotiator and a businessman. His negotiations have already started in that sense. He talked to the President of Taiwan which is anathema to the Chinese, but this means that he is starting the bargaining already. I think that you will see tough negotiations going on now.

[**Editor's Note:** Mobius also manages the Russian closed-end fund, Templeton Russia and East European Fund (NYSE:TRF) which invests primarily in Russia and East European countries. CEFA currently isn't invested in this fund, but the experience of meeting Mobius' Russian counterparts was interesting.]

SL: *The Economist* on February 11, 2017 wrote, "Can it end well? Donald Trump was seeking a grand bargain with Vladimir Putin who appeared to go much further than his predecessors."

> **"We believe it is important for investors to take a long view and not be swayed by short-term volatility."**

However, for him to think that Mr. Putin has much to offer is a miscalculation not just of Russian power and interests but also of the value America might have to give up in return. "The art of the deal meets the tsar of the steal."

Continuing, *The Economist* indicated: "America would team up with Mr. Putin to destroy 'radical Islamic terror' a particular Islamic state (IS) [while] at the same time Russia would agree to abandon its collaboration with Iran, an old enemy of America and a threat to its allies including Bahrain and Saudi Arabia."

Russia is a nuclear power with a leader who can't be trusted. The Kremlin's and America's interests are worlds apart.

"The idea of the Russians aiding the U.S. in a potential fight with China is probably not realistic. Russia is far weaker than China, as it has a declining army and population. Mr. Putin has neither the power nor inclination to pick a quarrel with Beijing. [Source: *The Economist*]

Mark, do you think that Trump might start a trade war with China or anyone else?

Mobius: I don't see a trade war developing because President Trump and his associates will realize that it will not be beneficial to the U.S. We need to remember that the new administration's objective is to create jobs in the U.S. An important part of that is expanding U.S. exports. In order to do that, agreements must be reached with other countries. For example, Trump could negotiate with Mexico to increase exports of oil field equipment and airplanes in exchange for allowing exports from Mexico to the U.S.

SL: According to *The Atlantic*, "China's land borders on more than a dozen countries connected by the East and South China Seas. There are territorial disputes with many of these countries, all of them on its maritime frontiers, because of its recent 'island building' program and insistence that has increased the military, fishing, and mineral exploitation rights in the region."

Mobius: There is no question what China is going through with the island building program. They want to control the route from the Middle East to Japan which is why the U.S. is concerned about the development.

SL: President Trump got a telephone call from Taiwan's President Tsai Ing-wen that caused an uproar in China. Is that correct?

Mobius: Yes. The U.S. has the right to recognize any country it wishes to recognize. Of course, American diplomats get very nervous when a tacit acceptance of the one China policy is suddenly reversed by the new President. This puts the Chinese into a state of high concern.

SL: We hope that will be resolved. President Trump has also tweeted threats that he might slap tariffs on Chinese and Mexican exports to the U.S. That could trigger several trade wars, according to several sources. This caused the Mexican peso to slump 3.5%. What is your reaction?

Mobius: President Trump, as I said, is a businessman and a negotiator. He understands that in order to have a successful negotiation both sides gain something. Therefore, I'm sure bilateral negotiations with the Chinese and Mexico will work out well.

President Trump is used to making deals, but my understanding is that on the diplomatic side of the argument, it is a two-sided agreement. Mr. Trump acts like this when he is making a deal as if it were diplomacy. We think that would be difficult.

Globalization

SL: By cutting the coal trade, Beijing "takes away Washington's excuse that the Chinese have all of the leverage" over Pyongyang (capital and largest city of the Democratic People's Republic of Korea, commonly known as North Korea). China exports are Pyongyang's single largest source of revenue, estimated to be more than $1.2 billion a year before the latest sanctions.

After Pyongyang conducted nuclear and ballistic-missile tests in 2016, Beijing backed tougher U.N. sanctions on North Korea's coal exports while ensuring an exemption for "humanitarian" needs.

Even so, Chinese officials have insisted that Washington bears a greater burden in dissuading Pyongyang, arguing that North Korea won't budge without some guarantees for its security. Beijing has long urged a resumption of talks with North Korea, which included the U.S. South Korea, Russia and Japan before Pyongyang walked out in 2009. [Source: Farnaz Fassihi, "U.N. Broadens Sanctions on North Korea," *The Wall Street Journal,* December 1, 2016.]

What is the current growth rate in China?

Mobius: Seven percent. A lot of people don't realize that 7% today in dollar terms is greater than 10% in 2010 because the economy has gotten a lot bigger in dollar terms.

[**Editor's Note:** In February 2017, *The Wall Street Journal* reported that China's growth rate has dropped to drop to 6.5%, which is close to a recession.

According to *The Globalist*, "The Chinese economy is just 40% smaller than the U.S. when measured at market exchange rates .... By 2014, the gap between the size of the Chinese and the U.S. has shrunk considerably, with China's economy now reaching $10.4 trillion and the U.S. one $17.4 trillion in GDP."]

China plans to clamp down on tighter controls from their companies that seek to invest overseas, intensifying efforts to slow a surge in capital that is fleeing offshore amid their tepid growth and an uncertain economic outlook.

"A lot of people don't realize that 7% today in dollar terms is greater than 10% in 2010 because ...."

SL: We are sure that the U.S. does not want that development. James Fallows, a well-known China scholar, spent many years in China and wrote the following in the December 2016 issue of *The Atlantic:* "China may be declining rapidly, calling this the 'Great Leap Backward.' China is now less free, less open, and more belligerent than it was five years ago, or even 10."

On another controversial subject, Thomas Friedman in his new book: *Thank You for Being Late: An Optimist's Guide to Thriving in the Age of Accelerations*, says that "many economists insisted that globalization was simply a measure of trade in physical goods, services, and financial transactions. Globalization, for me, has always meant the ability of any individual company to compete, connect, exchange, or collaborate globally .... By that definition, globalization is exploding as we can now digitize so many things and, thanks to mobile phones and the supernova, we can now send those digital flows everywhere and pull them in from anywhere."

Do you agree?

Mobius: Yes. A larger portion of China's economy is now in internet-related businesses and represents about 12% of the world's internet usage today.

That means that China is moving into the service sector. In fact, services as a percentage of the Chinese economy have surpassed that of manufacturing now. This includes the internet companies, like Alibaba, or any of the internet firms that are high tech.

We have also selected commodity shares that remain attractively valued, especially as the currently low commodity prices show signs of bottoming out. Oil prices, for example, are currently significantly higher from their recent lows.

SL: The Chinese global finance ministers are now having urgent meetings because globalization is hitting a wall. What do you make of this?

Mobius: The Trump presidency is challenging the global order that has existed since the end of World War II. This could have tremendous implications for how trade and investment will develop in the coming years.

SL: China has benefitted from the flourishing of trade and investments across national borders that many see as the magic of globalization. The whole story seems to be that economies which converged with their richer counterparts, such as Japan, South Korea and China have engaged globally in a selected strategic manner. China has pushed exports while placing barriers on imports, according to a report written by Jeffrey A. Frankel [Source: "Globalization and Chinese Growth: Ends of Trends?" HKS Working Paper Series, John F. Kennedy School of Government]

Mobius: We have seen that the U.S. dollar's rise has moved higher against the yen and emerging market currencies. The Mexican peso, the Brazil real and the

Malaysian ringgit have resisted the dollar's strength.

SL: Have you seen emerging market currencies force central banks in several nations to intervene in these markets?

Mobius: Actually there has recently been a reversal and a number of emerging market currencies have strengthened against the U.S. dollar. I believe that President Trump will try to weaken the dollar in order to boost exports.

Arctic Oil

SL: Now I would like to turn to Russian oil and gas production as they have ramped up their production. "Export terminals on Russia's Arctic coast is a clear priority for the Kremlin. Since July 2016, they started shipping an average of 230,000 barrels of crude." [Source: OilPrice.com]

Mobius: I used to be a director of the Russian oil company Lukoil, and we visited some of those places in Siberia. It gets pretty warm, but one place that we visited had a beach right on the lake in the summertime. It does, however, get cold, and the summers are short.

Russia's Arctic coast is a big area, and I think that the U.S., Russia and other countries have pretty much delineated which areas belong to which countries. There is a tremendous amount of drilling space in northern Siberia so I don't think there would be much conflict and there is little competition there. The area is very, very treacherous because of the potential for accidents.

SL: How treacherous is it?

Mobius: The temperatures can change very rapidly, and the cold can freeze equipment, causing havoc with mechanical equipment.

SL: I spent six months in 1963 on the U.S. Coast Guard icebreaker Northwind. While in the Alaskan Arctic, we saw dangers when the ship stopped on the ice that November. We were playing on the ice, when the cold started closing-in so fast that the crew had to set off dynamite to get the ship out of there.

Fortunately, we managed to get aboard quickly and get underway, but that was a close call. Later, an Admiral in Anchorage said: "It is a complex operation in a very environmentally difficult area; the weather is incredibly treacherous, and the logistics are difficult to deal with."

Some of the dangers of the Arctic Ocean are: (1) the noise, (2) the remoteness of the sea ice, and (3) slow ecological recovery from (oil) spills.

"The Arctic is the final frontier of the oil era. Overused oil fields around the planet are dwindling, tempting energy firms to tap the top of the planet despite its hostile environment. An estimated 13% of earth's undiscovered oil lies underneath the Arctic, totaling about 90 billion barrels. At our current rate of consumption, that would be enough to meet worldwide demand for about three years.

> ***Some of the dangers of the Arctic Ocean are: (1) the noise, (2) the remoteness of the sea ice, and (3) slow ecological recovery from (oil) spills.***

"Royal Dutch Petroleum has spent nearly $6 billion since 2005 on leases and lawsuits in its quest for Alaska's oil-rich seas. Unfortunately, they had a disaster when the ship ran aground. This was a major victory for the petroleum industry, but a devastating blow to environmentalists. [Source: Mother Nature Network]

The Coast Guard requires a least two heavy icebreakers to ensure continued access to the Polar regions and support our economic, commercial, maritime and national security needs. However, the Russians have 42 more icebreakers than we do, according to U.S. Coast Guard criteria.

The U.S. has vital national interests in the Polar regions. Polar icebreakers enable the U.S. to (1) maintain defense readiness in the Arctic and Antarctic regions; (2) enforce treaties and other laws needed to safeguard both industry and the environment; (3) provide ports, waterways and coastal security; and (4) provide logistical support (including vessel escort) to facilitate the movement of goods and personnel necessary to support scientific research, commerce, national security activities and maritime safety. [Source: Acquisition Directorate: Polar Icebreaker, U.S. Coast Guard]

"Competition in the Arctic among countries such as Russia, China and the U.S. has created a need for more eyes on everything from wildlife populations to ice cover to military activity." [Source: Audubon] We hope our readers will see how important the above information is for many reasons.

To continue with our global analysis, the global economic picture appears to be on course for a growth pick-up in 2017 with one large exception, India which has been in recession.

However, India is now forecasting to grow 7.7% in 2017, as they are benefiting from strong private consumption and significant reforms, according to *The Economic Times*. China and Brazil also appear to be on the mend.

SL: Please update us on Brazil.

Mobius: As the host of the 2016 Summer Olympic Games, Brazil had the opportunity to shine and it did. People found that it difficult to believe the economic situation would turn around in a downtrodden market like Brazil, but we have found that in general, the time of maximum pessimism marks the time when bottom is near. That is the time we want to be investing.

Given all of the dire headlines swirling around Brazil over the past year – corruption scandals, agency ratings downgrades and a severe recession – it may seem surprising that Brazil's stock markets are actually up dramatically. While the markets seem to be reflecting some optimism, it may take some time for Brazil's economy to recover. However, my recent travels there have confirmed the investment potential that we see in Brazil. Opportunities still exist there.

[**Editor's Note:** "The sprawling anti-corruption investigation is no longer weighing on Brazilian asset prices, and the local economy could recover quickly amid economic overhauls," Mark Mobius told *The Wall Street Journal* on February 20. "The executive chairman of Templeton Emerging Markets Group, who manages about $27 billion in assets, referred to investment jitters caused by the investigation centered on oil company Petroleo Brasileiro SA.

"Mobius said he has increased his exposure to Brazil and Mexico by about 15% to 20% since November because of growth expectations amid government reforms and attractive asset prices in Mexico."]

SL: Why do you no longer invest much in Africa?

Mobius: The problem with African countries is liquidity and price. At this stage, liquidity is very thin, and the number of opportunities you can get are relatively small. So, with the exception of South Africa, there is not much that we can get from Africa.

South Africa is pretty liquid right now. We have invested in banks in Kenya, but we have very little investments in Nigeria at least at this stage until they get their currency controls out.

However, emerging market stocks generally trended higher beginning in January as prices of many commodities rose. The People's Bank of China decided to implement further monetary stimulus measures, Greece finalized a new debt deal with its creditors, and Brazil impeached Dilma Rousseff.

Emerging market monetary easing measured by many central banks, notably the Bank of Japan and the Bank of England has improved the situation. In this environment, emerging market stocks as measured by the MSCI Emerging Markets Index, generated a +12.25% total return, with all major regions posting positive returns.

SL: Thank you, Mark, for your time today. It's great to hear from you again.

The World Belongs to the Optimists

Mobius answers the question: "Why invest in emerging markets?" when he writes, "The International Monetary Fund estimated that emerging economies were growing three times faster than the 2% growth estimated for the developed countries. However, there are many risks in investing in emerging markets, but they also [can] provide new investment opportunities, such as elevated economic growth, while domestic investing can be risky if investors overlook diversification that helps reduce investment risks."

We now want to give you the benefit of some of what we have learned from Mark's 50+ years of managing emerging market portfolios. We particularly admire his belief: "**The world belongs to optimists because it is necessary to be optimistic.**" Mobius says, "*The fact remains that there have always been problems throughout the world, and that will continue to be so in the coming years. But we are entering an era that is perhaps unpatrolled in the history of mankind.*

With higher income and living standards, better communications and technology with improved travel, greater international trade and generally better relations between nations, emerging markets investors have the perfect opportunity to capitalize on the benefits.

Stock markets eventually reflect economic growth in the long haul. But like all markets, the emerging markets tend to be cyclical." ■

Disclosures

Clients and employees of CEFA as well as its family members own shares of EMF at the time of this interview. We will wait three business days after publication before executing any buys or sells in EMF, TEI and GIM.

Beware of Sovereign Risks in Emerging Markets

Last July, a tiny Philippine Stock Exchange – much smaller than Thailand's or Indonesia's – advanced more than 30%. After Rodrigo Deterge was elected president, the stock benchmark dropped nearly 8% from its apex. (Source: *Financial Advisor Magazine*)

President Deterge ordered the killing of thousands of accused drug dealers, kicked U.S. forces out of his country and made other incendiary moves. This scared away large institutional investors and highlighted the risks of some of these markets, especially those exhibiting erratic government behavior. We avoid investing in these countries.

When an emerging market tumbles, Mark looks to see if it meets his investment criteria, then he buys because "that is where the growth is." He also says it is more important to sell when a much better investment is available to replace it.

Closed-End Fund Advisors has a better-than-average performance by investing our clients in several Franklin/Templeton closed-end funds. This includes investing in The Templeton Emerging Markets Fund (NYSE:EMF). We also invested in Franklin/Templeton global sovereign bond funds that provide steady income. ■

Portfolio Managers' Review

CEFA has invested in several Franklin/Templeton funds: Templeton Emerging Market Fund (NYSE:EMF), Templeton Emerging Markets Income Fund (NYSE:TEI) and Templeton Global Income Fund (NYSE:GIM). These funds help balance our portfolios with their steady income, while we also invest in a wide array of U.S. and global closed-end bond funds.

Robust consumer spending, an uptick in factory production and firming inflation are continuing to give a healthy start for the U.S. economy. Market data as of February 23, 2017 indicate that the U.S stock markets reached another new high of 20,810, while the S&P 500 index also closed at 2,361.81; and futures for Brent crude oil closed at 56.45, gold at 1,250.50 and silver at 18.2445.

As a result, we think this may be good a time to retain some cash reserves in case of any resurgence in market volatility. That way, we can be prepared for new opportunities. Other fund managers have also increased their cash reserves as well.

As value investors, we do our best to manage funds that focus on stocks that have low metrics relative to their price/earnings ratios. Many investors speak of "value investing," but few actually apply those investing principals and perform the hard work necessary to fund real value.

Most of our clients who invest with us in rapidly developing but volatile emerging markets pursue growth rather than value strategies. This is because most value investors have trailed growth emerging market investors in four of the past five years.

"From 2011 to 2015, emerging market value funds lost 38%, while those with a growth tilt fell 21%," according to MSCI Inc. "However, in 2016, value funds in emerging markets have risen substantially, beating the previous gains in the broad emerging market index. Economic indicators have perked up, and unemployment in December 2016 was 4.7%, with consumer confidence at near multi-year highs."

We see strong stock markets, especially since the earning picture has improved substantially.

Market data indicates that the Standard & Poor's 500 stock index have been trading higher in early January 2017 than at almost any time in history.

All of the changes in government policies, such as raising tariffs on imported goods for a more investor-friendly environment, is what could happen if we lower individual and corporate tax rates. This could reward exporters and punish importers.

As we are in still in a bull market, we are reluctant to raise too much cash unless the opportunities are overwhelming. We have added to our clients' positions in The Swiss Helvetia Fund as we see this Fund as a means to increase diversity into funds that have a defensive nature. It also allows us to own part of a strong European fund.

Some of the biotech and healthcare funds weakened last quarter, giving us the opportunity to pick up some of these funds at bargain prices. We continue to look for opportunities like this.

This year, value funds in emerging markets are up 20%, beating the 15.5% gain in the broad emerging market index, according to Morningstar. This fiscal year seems to be the fastest growing in a long time for larger developing economy, as it benefits from strong private consumption and significant global reforms.

If you have any questions about this or other matters, please contact us anytime. We also enjoy working with all of you and look forward to welcoming new clients who understand the value of investing in closed-end funds. ■

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