

## Interview with Sir John Templeton

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1 April 2004 SmartMoney

Sir John Speaks --- He bought low during the Depression, sold high during the Internet boom and made more than a few good calls in between; Sir John Templeton, dean of contrarians, tells us where to invest now

Spend five minutes in Sir John Templeton's offices and you'll learn a lot about the legendary value investor. It's not the imposing portrait, the honorary degrees or even the certificate of knighthood. It's the books. Crisis Investing shares shelf space with Eat Right for Your Type. The Hand of God sits near Invest for Retirement and Natural Capitalism. Several thick volumes occupy substantial real estate on the top shelf. An investing bible? No -- it's the 1991 edition of the London Central Yellow Pages.

A 1934 Yale graduate and Rhodes scholar, Templeton has a voracious appetite for information. The small-town Tennessee native became known as the Marco Polo of his Oxford class, thanks to a round-the-world postgraduation jaunt. In his late 20s he opened his own money-management firm and began to put international investing on the map. His flagship Templeton Growth fund has posted a 13.8 percent annualized return over 50 years, well ahead of the Standard & Poor's 500's 11.1 percent.

Templeton's track record is full of prescient moves. In 1978, when Ford was near bankruptcy, he was a buyer. When everyone else piled into tech in 2000, he was a seller.

Though he now lives in Lyford Cay, a decidedly well-heeled corner of the Bahamas, Templeton maintains a surprisingly modest lifestyle. He tools around at the wheel of a Lincoln Town Car. Orchids and bougainvillea upstage his whitewashed home. It's the ideal setting for a quiet retirement, but that's not Templeton's cup of tea. Since Franklin Resources bought his funds in 1992 for \$440 million, he has devoted most of his time to philanthropy. The John Templeton Foundation gives \$40 million a year to projects that explore the intersection of science and religion. Templeton's longtime philanthropic efforts earned the naturalized British citizen a knighthood in 1987. In his spare time, he hunts for global bargains, and at 91, he's clearly as curious as ever. As SmartMoney sat down in his cluttered conference room, it was Templeton who fired off the first question: "Have you written any books I can read?" Well, no. But enough about us.

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SmartMoney: How did a kid from rural Tennessee become a pioneer of global value investing?

John Templeton: In Tennessee I didn't meet anybody who owned a share of anything. At Yale there were hundreds of boys from wealthy families, but not a single one who was investing outside one nation. I thought that was just not sensible. Surely they'd get better results if they searched everywhere rather than limiting their search to one country. Then I investigated the investment counsel profession and couldn't find any investment counselor who specialized in helping people invest outside America. So I saw a wide-open opportunity.

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Q: In 1939 you bought \$100 worth of every New York Stock Exchange listed stock that was trading under \$1 per share. There were 104 names, and 37 were already in bankruptcy. Why did you do it?

John Templeton: I was sitting in my office at 30 Rockefeller Plaza in Manhattan when the news came out that Hitler had invaded Poland. It was obvious within a few days that it was going to lead to the Second World War. During war, everything that was in surplus, and therefore unprofitable, becomes scarce and profitable. Three years later I had a profit on 100 out of the 104.

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Q: What signs helped you see that the U.S. technology bubble was about to burst back in 2000?

John Templeton: If you want to have a better performance than the crowd, you must do things differently from the crowd. Four years ago the crowd was piling into tech stocks. The prices went sky-high. I sold my clients' technology stocks, and sold a lot of them short. I have put these philosophies into a simple statement: Help people. When people are desperately trying to sell, help them and buy. When people are enthusiastically trying to buy, help them and sell.

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Q: That's a good way to look at it.

John Templeton: That's mainly a joke.

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Q: In 1992 you predicted that "the next 10 years will be the happiest period, and the most progressive," with "rapidly increasing prosperity for both Europe and America." Are you as optimistic about the next decade?

John Templeton: Very few people realize how fortunate we are to live in the most glorious period in world history. There has been more progress in

prosperity than in any previous century. The Dow Jones Industrial Average never went above 100 until a century ago. Now it's up to 10700, a hundredfold increase in one century. Probably in the next century, the increase will be equally great, if not greater. But I have to say that we are starting from an unusually high price for shares, not just in one industry, but in practically all industries and all nations.

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Q: What is your view of current U.S. stock valuations?

John Templeton: Over the next five years, the chances are about 50/50 that the stock market will be lower. There is a risk that stock indexes will go down by over 30 percent or they'll go up 30 percent. Share prices are remarkably high right now. The Nasdaq Composite index is trading at 36 times next year's earnings and 95 times last year's earnings. That's high. For most of my lifetime I found bargains one place or another below 12 times earnings.

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Q: How does this environment compare with the market of 1972, when the Dow regained its late '60s highs of around 1000 but didn't break through that level again until 1982?

John Templeton: That was a period of stock market optimism, which goes in cycles. There are at least five of these cycles every century. The one in those years you mentioned was a normal cycle. This one seems to be more exaggerated. Prices in those years never went as high as they are now.

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Q: Are there any sectors in the U.S. that look cheap?

John Templeton: No. I wish there were, but I can't find them. The answer is to play safe. And playing safe means diversifying among nations, industries and types of securities. At present I don't think anybody should have over half their assets in common stock.

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Q: And you believe that no one should have more than 50 percent of his or her portfolio in a single country?

John Templeton: Yes. And no more than 25 percent in one industry.

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Q: Do you think there is a real estate bubble in the U.S.?

John Templeton: Yes. Real estate is very different from the stock market because it's so local and separate in terms of type. But in many locations and many types of real estate, prices are dangerously high right now. And

in real estate it's easier to say what's dangerously high. You just look at what it costs to rebuild. Right here in the Bahamas, I have recently seen people pay four or five times for a house what it would cost to rebuild.

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Q: Do U.S. bonds look more attractive than equities?

John Templeton: Compared to the cost of living [measured by inflation], you can still buy American bonds. But at present there are bonds of other nations that seem safer. It's wise to invest in nations that do not have an unfavorable balance of trade or a government deficit.

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Q: Which countries seem the safest?

John Templeton: There are not many. There are almost 200 nations on earth and about 150 different currencies, and most of them have problems even greater than America's. But Singapore, Hong Kong, South Korea, New Zealand, Australia and Russia don't have big problems.

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Q: A few years ago you were buying STRIPs, or Treasury bonds with the coupons cut off. Do you still like them?

John Templeton: I bought STRIPs because the yield to maturity was about 10 percent better than what you could get on Treasury bonds. But I found I did better by changing from U.S. Treasury STRIPs to STRIPs of nations with stronger currencies, like the ones we just talked about.

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Q: Where do you think the U.S. dollar will go from here?

John Templeton: The chances of the U.S. dollar going down in relation to the euro are no more than 50/50. The euro has already gone up 47 percent in the last two years. But the yen is up only 25 percent. Japan has put hundreds of billions of dollars into buying American money. The quantities are so great that that can't continue much longer. Japanese money is likely to go up in the future.

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Q: Are you concerned about inflation?

John Templeton: Long term, because we have more and more democracies in the world,

we're going to have more and more inflation. Politicians who are willing to spend too much are the ones who get reelected. Look back at history. Inflation has averaged about 2 percent a year. Probably, it

will average somewhat more than that in the next century. But from a short-range standpoint, there does not yet seem to be a shortage of almost any product. Until there's a shortage, you're not likely to see higher prices.

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Q: What do you see as the biggest threat to economic recovery in the U.S.?

John Templeton: We don't need an economic recovery because we're already operating at a very high level. The greatest threat to maintaining this level of economic activity is debt. There's never been a time when people worldwide, and especially in America, had such a high proportion of debt. I think 20 percent of people who have mortgages on their homes are likely to lose them in foreclosures. When a home goes into bankruptcy, it's sold at auction. That pushes the price down and affects the prices of other homes.

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Q: Does the U.S. government's debt level worry you?

John Templeton: Oh, yes. There has never been any government anywhere in the world that has such a big deficit in the federal budget. And there's never been a nation in history that had such an adverse balance of trade. However, if you look at those debts and balance of trade as a percentage of gross national product, they're bad, but not unprecedented.

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Q: What does that mean for investors?

John Templeton: It's one more reason why this is a dangerous time to own stocks.

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Q: Even foreign equities?

John Templeton: Yes. In my long history I could always find some nation where people were desperately trying to sell. Now I can't find a place where people are trying desperately to get out of equities.

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Q: So what do you think about the rush to invest in China?

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John Templeton: The cycles will be much wider and more frequent in China because of the lack of information. Having said that, if you're investing, you should put a fairly large part of your total assets in China because

within as short a period as 30 years, China is likely to have the largest gross national product any nation has ever had.

Q: Is India as great an opportunity as China?

John Templeton: Yes. You could say almost the same thing about India, except in terms of speed. The improvement in India is wonderful but not as fast. But the Indian market is up more than 80 percent in 12 months. That's a danger signal. It means you're going to take a lot of risk that you wouldn't have taken a year before.

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Q: What's the world's best stock market now?

John Templeton: The best answer is none. There are so many securities analysts working on that question that the prices in different markets are less out of line than normal.

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Q: So an influx of information has made life difficult for global value investors?

John Templeton: When I became an investment counselor, there were only 17 security analysts on earth. Now, in America alone, there are more than 32,000, and they do have an effect on prices by doing research on where to find bargains.

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Q: If you were starting out in the investing world today, what would you do?

John Templeton: Play safe. If you don't have your money in equities, it's very difficult to find a place to put it. Gold has already gone up. . . . People also tend to think it's safe to put your money in the bank. When I was studying in the U.K., people swore that it was safe to put your money in pounds sterling. But within a few years, sterling went down from \$5 a pound to \$1.50 a pound because of the war. If gold and bank accounts are no longer safe, where can you put it? Diversify. Don't put too much in any one thing.

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Q: What have you been buying lately?

John Templeton: I believe there are fewer opportunities than I've ever seen in 91 years. In the last year I've been using market-neutral hedge funds, whose policy is to have always the same quantity of longs and shorts. I have invested lately in two funds that are managed by people who worked for me when I was in the investment business: Jane Siebels-Kilnes' Siebels Multi-Fund and Mark Holowesko's Holowesko Global fund. They

aren't registered with the SEC, however, so American stockbrokers can't sell them.

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Q: After the corporate scandals of recent years, how can we restore trust in the markets?

John Templeton: The answer is comparison. When you're worried about those scandals, stop and think, what nation would you feel safer in? At what time in world history could you feel safer? I don't think you'll find any time when the degree of information, the degree of honesty, is higher than it is today.

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Q: You don't think there's anything the government should do to restore trust?

John Templeton: Yes. Keep their hands off. It has been proven over and over that the best regulation is free competition. Those that are not doing a good job for the public get squeezed out. I can't think of any nation where the quantity of regulation is already not too high.

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Q: A couple of days ago, Franklin Resources, the firm that bought your funds, was accused of participating in market-timing arrangements. What's your take on the fund scandal?

John Templeton: Everything I've just said applies double to that. Can you think of any industry or any nation where there are fewer questionable practices than there are in American mutual funds? I can't. If all the claims in the news were added up, what would it cost a mutual fund owner? One cent.

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Q: You've lived here in the Bahamas for 31 years . . .

John Templeton: Yes. I've found my results for investment clients were far better here than when I had my office in 30 Rockefeller Plaza. When you're in Manhattan, it's much more difficult to go opposite to the crowd.