BEYOND THE HEADLINES (PART ONE)

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World markets have taken us on a bit of a ride over the past few months with concerns about China, emerging markets and the possibility of a US interest rate rise pushing markets down significantly.

However, in investing, you often find that beyond the negative headlines is a deeper truth – a truth that gives you an opportunity to buy good assets at low prices. I think that's happening right now.

CHINA – STOP LOOKING AT THE FACTORY FLOOR (AND GO SHOPPING)

While the world has been focusing on weakening Chinese manufacturing and lower production, they have ignored the services sector, which continues to grow dramatically. While manufacturing makes up 42% of GDP, services now account for 48% and are growing at about 9% p.a.

This is a historic shift; exactly the kind of move Chinese policy makers have been trying to engineer and it's why overall Chinese GDP continues to grow. The big positions we have in Chinese companies are in the services sector where we continue to see very strong revenue and earnings growth. So while everyone's worried about factory floor numbers, we're happy to invest in Chinese technology, insurance and retail businesses.

EMERGING MARKETS HAVE GROWING PAINS

The growth problems facing emerging markets are real – and could take some time to work out. But focusing too much on problems in countries like China, Brazil (lack of reform) and Russia (too dependent on oil) can blind you to some big lessons.

1. **The benefits of diversification**
   Paradoxically, China's current woes are a reminder of the benefits of sending your money overseas. In Australia, GDP growth dipped to an anaemic 0.2% in the June quarter due to weakness in exports, mining and construction. As a country, we are overexposed to Chinese manufacturing. But by investing internationally you can put your money to work in more rewarding areas.

2. **Hometown USA**
   Right now, we believe that's in the US. Indeed US companies represent close to 60% of our portfolio. Other than stronger growth (GDP was up 3.7% in the June quarter) one of main reasons is that the US is very self-reliant. While we think of the US as a powerhouse of global brands (Apple, Microsoft et al) the US is much less affected by weakness in export markets than you might think:

   - internal consumption represents 67% of US GDP
   - exports account for only 13% of GDP
   - only 2% of the revenue of the S&P 500 companies is generated in China.

The other key element of our preference for the US is price. As a value investor, we're always looking at the price we pay for a company's future earnings. In the recent correction the forward Price to Earnings (PE) multiple for the US S&P 500 fell from 16-17x earlier in the year to below its long run average of 15x. As a result we have been adding to our positions in some quality US companies. We are finally getting the chance to be greedy while others are fearful.

In part two of this article I'll look more closely at some of the US companies we're investing in and at why rising US interest rates may actually be good for share investors…