FRANKLIN TEMPLETON INVESTMENTS

Investment Team Update

6 December 2017

Investment Strategy and Research Committee Allocation Views

PERSPECTIVE FROM FRANKLIN TEMPLETON MULTI-ASSET SOLUTIONS

This investment team update describes the views of the Franklin Templeton (FT) Multi-Asset Solutions Investment Strategy and Research Committee (ISRC)—an experienced team of investment professionals who specialize in equities, fixed income, cross asset and absolute return investments. The committee meets regularly to share multiple viewpoints, debate implications and assess risks. This process generates key investment themes, which can be expressed in a variety of portfolios that FT Multi-Asset Solutions offers to clients.

The text below describes the views of the FT Multi-Asset Solutions ISRC as at the date of this publication. These views are for general information only, are subject to change, apply solely to FT Multi-Asset Solutions' strategies and are not representative of the views or strategies of other Franklin Templeton investment groups.

Major Themes That Frame Our Tactical Asset Allocation		
Continued Global Growth	Subtle Inflation Pressures	Business Cycle Remains Supportive

Executive Summary as at 6 December 2017

- **We favor risk assets due to synchronized global economic growth, modest inflation and supportive liquidity conditions.** This generally translates into our preference for equities relative to fixed income. Within fixed income, we prefer short duration exposure and, on a regional basis, emerging-market debt (EMD). From an equity perspective, we prefer non-US exposure, including Japan and emerging markets.
- From an economic perspective, **global growth continues to expand at a modest pace.** Leading economic indicators continued to remain upbeat—notably purchasing managers' indexes (PMIs) and confidence measures. We believe global growth is now best characterized as synchronized, which has rarely occurred outside of the original recovery from the global financial crisis. Furthermore, corporate indicators were also positive, with rising earnings-per-share growth and strong profit margins.
- Economic strength has persisted, despite modest inflationary pressures. We expect inflation to subtly trend higher over the next few years, **but we do not expect a sudden "shock" in inflation pressures.** While we find some evidence that inflation weakness this year has been due to idiosyncratic factors, we believe low inflation expectations and global influences should prevent a sudden rise in inflation pressures moving forward. However, we remain watchful of the potential for higher growth and tight labor markets to place upward pressure on prices and wages.
- Major central banks remain in the spotlight as the US Federal Reserve (Fed) commenced balance sheet normalization, US President Donald Trump announced the nomination of Jerome Powell to succeed the current Fed chair, and the European Central Bank (ECB) announced it will taper its quantitative easing program in 2018. In broad terms, asset prices have reacted positively to these developments. We view this market reaction as important, given concerns that the reversal of some monetary policies could result in reduced support for asset prices. **Our analysis suggests the liquidity environment should remain quite accommodative,** with aggregate central bank balance sheets likely expanding through 2018 and policy normalization continuing, supported by a stronger macroeconomic outlook.
- **We have been monitoring a few potential risks.** First, while we believe this synchronized global growth can continue, we closely monitor economic data for signs of a slowdown in momentum. Sentiment indicators—which we would characterize as optimistic—have begun to catch up to the growth story, which makes us **slightly more cautious of risk asset performance potential in the near term,** particularly in such a low volatility environment. Lastly, elevated global equity valuations as at November-end imply more muted to forward-looking performance expectations long term, in our view.

Current Convictions from the FT Multi-Asset Solutions ISRC

	Asset Class	(-) N (+)	Our Viewpoint
MAIN ASSET CLASSES	**Equities**		Global synchronized recovery is supported by rising corporate earnings and profit margins. Liquidity environment to remain accommodative across developed markets (DMs), despite some announcements of policy normalization from the Fed and the ECB. Valuations expensive versus history, but still attractive relative to fixed income. Thirteen consecutive months of positive global equity total returns and the longest period without a 3% drawdown in the history of the MSCI All Country World Index keep us vigilant in the near term.
	Corporate Bonds		Global recovery and positive corporate outlook supportive, although we have observed several signs that the credit cycle is in its late stage and warrants some caution. Technical factors and proposed fiscal measures supportive. Valuations generally remain stretched, but less so in EMD.
	Government Bonds		Improving global growth with inflation trending higher warrants lower exposure to government bonds and duration. Valuations notably expensive, highlighted by low term premiums. Normalization of central bank policy also a headwind for government bonds. Low expectations for performance potential on a total return basis.
	Commodities		Improving global growth a tailwind, especially as higher profits and improved business confidence should lead to higher capital expenditures, which could benefit commodities. China also continues to exhibit steady growth, and the country's focus on "One Belt, One Road" clearly benefits industrial metals. Supply/demand balance in oil has improved as well.
	Cash	←	With a "Goldilocks" environment for many risk assets and generally low yields in fixed income, we believe a neutral view on cash is appropriate.
EQUITY REGIONS	**Developed (DM)**		Economic indicators positive relative to history, driven by upside economic surprises, PMIs, industrial production and retail sales. Corporate fundamentals have remained upbeat as earnings revisions improve and margins trend upward. Inflation remains subdued despite strengthening labor markets, which is keeping monetary policy accommodative. Valuations elevated, with most metrics over one standard deviation higher relative to history.
	United States	→	Economic growth prospects remain solid and momentum toward a tax reform bill continues apace. Corporate revenue growth, profit margins and earnings momentum remain strong. Indications from Fed chair nominee Jerome Powell about maintaining existing monetary policy seen as a tailwind for US equities. Valuations, however, were elevated, with most metrics over one standard deviation above 10-year history.
	Europe	←	Economic recovery continues, even as ECB slowly begins to normalize policy. Earnings momentum and revisions have remained positive, and we expect this to continue as eurozone growth is coming off a lower base than most regions. Valuations expensive versus history, but still attractive to us compared to DM peers. Concerns over potentially plateauing profit margins, a strong euro's impact on corporate profitability and nascent tightening of credit conditions have led us to downgrade our view on European equities.
	Japan		Economic indicators continue to remain strong, and a recent electoral victory by Prime Minister Shinzo Abe suggests this momentum will continue. Profits continue to be a key driver and remain at both cyclical and structural highs. Central bank policy is likely to remain supportive, especially given Abe's victory. Japanese equities could benefit from strong leverage to the global economic acceleration taking place. Relative valuations attractive to us compared to DM peers.
	Canada		Economic surprises have begun to roll over, and there remains some worry over the housing market and its potential to slow economic growth. We have started to see a slowdown in retail sales, especially in housing-related categories. This was affirmed by the Bank of Canada, which recently left interest rates unchanged after raising rates two times earlier this year.
	Emerging (EM)		EM equities have continued to perform well, even as the US dollar has strengthened recently. This is likely due to continued economic growth improvement, led by China. Valuations still appear attractive to us versus DM peers, and evidence points toward investors still underweighting EMs versus DMs, which should be a continued tailwind.
FIXED INCOME SECTORS	US Treasuries		The Federal Open Market Committee dot plot continues to price in a more aggressive interest rate path than market expectations, although market expectations have increased steadily over the past month (most now expect two hikes next year versus one previously). Tax reform is likely to increase deficit, although we do see more relative value in Treasuries vs. DM peers. Powell nomination for Fed chair implies Fed policy to remain unchanged.
	Ex-US Govt. Bonds		Valuations especially expensive, particularly in the eurozone, where term premiums were the lowest among government bonds. Abe's electoral victory bodes well for continued Bank of Japan yield curve control policy.
	High Yield	←	The economic backdrop remains supportive of riskier fixed income sectors like high yield. We see supply/demand conditions improving in the next few months. There is also a positive trend in upgrades within the sector. Bank loans can be an attractive complement to high yield, given their reduced sensitivity to rate hikes.
	Investment Grade (IG)		Investment-grade sector has more duration risk than other sectors. Corporate fundamentals stable; however, leverage is quite high and valuations have been tight.
	EM Debt		Improving growth prospects and declining macro vulnerabilities are supportive for EMD. EM local debt has attractive real yields relative to DM peers. We view selective positioning as important, as there are many idiosyncratic outlooks. We have a preference for local currency debt versus hard currency.

→/← Represents month-over-month change   No arrow = No change from the previous month

The graphic reflects the views of the ISRC regarding each asset class relative to a neutral portfolio allocation. All viewpoints reflect solely the views and opinions of the ISRC. Equity regions and fixed income sector totals roll up to the main asset classes.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. Bond prices generally move in the opposite direction of interest rates. Thus, as the prices of bonds in an investment portfolio adjust to a rise in interest rates, the value of the portfolio may decline. Special risks are associated with foreign investing, including currency fluctuations, economic instability and political developments. Investments in emerging markets, of which frontier markets are a subset, involve heightened risks related to the same factors, in addition to those associated with these markets' smaller size, lesser liquidity and lack of established legal, political, business and social frameworks to support securities markets. Because these frameworks are typically even less developed in frontier markets, as well as various factors including the increased potential for extreme price volatility, illiquidity, trade barriers and exchange controls, the risks associated with emerging markets are magnified in frontier markets. Derivatives, including currency management strategies, involve costs and can create economic leverage in a portfolio which may result in significant volatility and cause the portfolio to participate in losses (as well as enable gains) on an amount that exceeds the portfolio's initial investment. A strategy may not achieve the anticipated benefits, and may realize losses, when a counterparty fails to perform as promised. Currency rates may fluctuate significantly over short periods of time and can reduce returns. Investing in the natural resources sector involves special risks, including increased susceptibility to adverse economic and regulatory developments affecting the sector—prices of such securities can be volatile, particularly over the short term.

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