FRANKLIN TEMPLETON INVESTMENTS

Investment Team Update

10 September 2018

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

Global Growth Moderates	Modest Inflation Pressures	Strong Corporate Fundamentals

Executive Summary as of 10 September 2018

- The global financial market narrative has remained focused on emerging markets (EMs), although attention has largely shifted as the trade war storyline has taken a back seat to EM contagion concerns. Many investors were still grappling with the impact of a debt crisis in Argentina when Turkey's bond and currency markets seemed to unravel. **From our perspective, the key question is whether these EM episodes are idiosyncratic, or if they are signalling the onset of broader downturn in EMs as developed-market central banks, particularly the US Federal Reserve (Fed), slowly normalize monetary policy**.

- As we enter September**, our analysis points to evidence that the most recent flareup in EMs is idiosyncratic, rather than an early symptom of broader EM weakness**. One reason why we think country-specific factors are responsible is that both Turkey and Argentina appear to be two of the more vulnerable EM countries, based on several fundamental metrics. For instance, Turkey's current account deficit had begun to deteriorate in the middle of 2016, which also coincided with rising inflation (from around 7% to 17.9% annualized).[1] A recent yet significant catalyst weighing on Turkish assets proved to be additional US sanctions, which stemmed from Turkey's continued detainment of a US pastor. We see these sanctions as a prime example of an idiosyncratic issue that, while detrimental to Turkey, has little value to evaluating EMs as a group. Furthermore, we note that Turkey and Argentina combined account for less than 2% of world gross domestic product.[2]

- In contrast, we analyse broader macro forces to understand if we're in the early innings of EM contagion. **For example, a greater worry for EM asset performance would be if the Fed were to tighten monetary policy to a greater degree than the market currently expects**. Clearly, the Fed is in the driver's seat in regard to normalizing monetary policy, and we were given only slightly more detail from the August Jackson Hole summit, which is often looked to as a guide for future monetary policy. **Fed Chair Jay Powell continued to state that gradualism in further rate increases will likely be appropriate,** and the central bank has not indicated that international risks call for this view to be revised. **His view mimics our own macro outlook, which remains more optimistic and seeks to filter out the "noise" generated by a few EM countries.**

- A substantial slowdown in Chinese growth would also warrant more caution for the EM complex. **However, a dramatic slowdown in China is not our base case scenario**. We find sufficient evidence that a policy-led growth upturn in the country has been offsetting slower growth, which is primarily stemming from the People's Bank of China (PBoC) deleveraging the country's shadow banking sector. Chinese leader Xi Jinping and the PBoC have encouraged lending, cut interest rates and increased fiscal spending in recent months. For example, the Chinese government approved a number of major urban infrastructure projects, providing further tailwinds for growth.

- From a US/China trade standpoint, we realize there is still room for improvement as new tariffs were recently, and unexpectedly, announced. **The US-China trade standoff contrasts with other trade agreement developments throughout the world, which largely have been improving, with examples including autos and a "new" North American Free Trade Agreement (NAFTA).** With US midterm elections arriving in November, it seems likely that more trade headlines may surface and cause some volatility along the way. However, we remain focused on what we view as a strong macro and corporate backdrop.

Current Convictions from the FT Multi-Asset Solutions ISRC

	Asset Class	(-) N (+)	Our Viewpoint
MAIN ASSET CLASSES	**Equities**		Global recovery still supported by rising corporate earnings and profit margins, although we are monitoring growth momentum as we are seeing more desynchronization throughout the world. Monetary policy becoming less accommodative, but fiscal policy looks set to pick up the slack. We are carefully monitoring inflation and the potential for increased market volatility.
MAIN ASSET CLASSES	**Corporate Bonds**		While technical factors and proposed fiscal measures are supportive of corporate bonds, conditions regarding cash repatriation and merger-and-acquisition activity continue to evolve. Bank loans have been looking more attractive to us within corporate credit, given upside movement for interest payments and less duration risk.
MAIN ASSET CLASSES	**Government Bonds**		Improving global growth with inflation trending higher leads us to prefer lower exposure to government bonds and duration. Valuations have remained expensive despite the rise in yields, highlighted by low term premiums.
MAIN ASSET CLASSES	**Alternatives**		With alternatives, we prefer assets that have historically performed well late in the economic cycle, such as real assets (including commodities) and US Treasury Inflation-Protected Securities.
MAIN ASSET CLASSES	**Cash**		Cash yields have trended upward, with short-term US Treasury bill yields supported by greater supply and gradual monetary policy normalization. A fairly flat yield curve is generally raising the attractiveness of cash to us.
EQUITY REGIONS	**Developed (DM)**		The positive economic growth story in developed markets, led by the United States, appears to remain intact despite increasing divergence throughout the world. Corporate fundamentals are currently on par with historical averages, with above-average margins and healthy earnings revisions.
EQUITY REGIONS	United States		Despite elevated geopolitical headlines and trade tensions, growth fundamentals continue to be positive, with tax reforms providing a tailwind for earnings and valuations at reasonable risk/reward levels compared to the macro backdrop of low unemployment and moderate inflation.
EQUITY REGIONS	Europe ex UK		Several concerns have remained in play, and economic headlines are slowing in pace, though valuations have appeared reasonable to us relative to potential reward.
EQUITY REGIONS	United Kingdom		Recent British pound weakness has helped boost short-term performance in the UK equity market. However, the Brexit path forward remains unclear. We expect the domestic economy to face headwinds.
EQUITY REGIONS	Japan		Valuations for Japan's equity market, particularly on a price-to-book value basis, have remained attractive to us relative to other markets. Corporate fundamentals have remained quite conservative, with forward expected earnings growth at significantly lower levels than peers. Some interim concerns for us are moderating global growth, moderating profit margins and increased trade tensions.
EQUITY REGIONS	Canada		We see select opportunities within Canada, with financials benefiting from a rising interest-rate environment, and the energy sector benefiting from higher crude oil prices. However, uncertainty remains in the form of an economy running at capacity, a stretched consumer, signs of falling home prices, and NAFTA negotiations still in play.
EQUITY REGIONS	Pacific ex Japan		With banks and related financial companies representing heavier weights in the region, concerns about Australian banks have remained due to lower expected loan growth, higher regulatory costs and dividend payouts that appear unsustainable.
EQUITY REGIONS	**Emerging (EM)**		In general, EMs continue to post improving consumer growth; however, complications from trade tariff escalation may continue with US midterm elections in November. Although Fed policy normalization and some EMs showing signs of vulnerability (e.g., Argentina and Turkey) present headwinds, profit margins and return-on-equity ratios have stabilized in the past month.
FIXED INCOME SECTORS	US Treasuries		The Federal Open Market Committee dot plot is still pricing in a more aggressive interest-rate path beyond 2018 than market expectations. Though the Fed chair's comments in Jackson Hole reiterated a steady pace for interest-rate increases, we believe the markets continue to underestimate the pace in later years. As a result, we prefer short duration exposure.
FIXED INCOME SECTORS	Eurozone Govt. Bonds		Valuations have appeared especially full in the eurozone, where term premiums are the lowest among government bonds. Quantitative easing from the European Central Bank is scheduled to end in December. Italy's new government presents its budget in mid-September, with uncertainty leading up to the announcement.
FIXED INCOME SECTORS	Japan Govt. Bonds		The Bank of Japan updated its monetary policy stance by widening its tolerance band on 10-year government bond yields, but it was also able to effectively maintain its guidance that key interest rates remain unchanged and will remain so for an "extended period."
FIXED INCOME SECTORS	High Yield		While valuations have been tight, we believe the economic backdrop remains supportive of riskier fixed income sectors such as high yield. Less new issuance in high yield in 2018 so far is helping supply/demand balance. There also has been a positive trend in upgrades within the sector. We believe bank loans can be an attractive complement to high yield, given less sensitivity to Fed rate hikes.
FIXED INCOME SECTORS	Investment Grade (IG)		The investment-grade sector has more duration risk than other bond sectors. Corporate fundamentals are stable; however, leverage is high and spreads have been tight, while technical conditions are less supportive. We expect a higher ratio of downgrades to upgrades.
FIXED INCOME SECTORS	EM Debt		Turbulent credit markets in Turkey and Argentina were indicative of how countries with weak fundamentals may be targeted. In contrast, we find a number of EM countries have enough buffers to withstand sector headwinds. We therefore view selective positioning as important, as some countries are more exposed to the rising cost of capital.

→ / ← 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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1. Source: Turkish Statistical Institute. As of August 2018.
2. Source: International Monetary Fund, 2017.

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