FRANKLIN TEMPLETON INVESTMENTS

Investment Team Update

31 October 2018

A Sea of Opportunities

EMERGING MARKETS INSIGHTS

Three Things We're Thinking About Today

1. Jair Bolsonaro emerged victorious in **Brazil's presidential election**, solidifying investors' optimism for a more market-friendly policy approach. Looking forward, we believe this should be positive for earnings growth and for the Brazilian equity market generally. Political stability could also result in a more favorable climate where consumer and business confidence can pick up again and lead to an acceleration in domestic economic activity. The local market is trading at what we view to be reasonable price-earnings levels and should have more scope for improvement as the economic situation improves. Initiatives such as pension reform and an acceleration in privatization could also be expected under the next president as part of efforts to tackle the deficit, improve the efficiency of the state-owned companies and lower corporate taxes.

2. We believe China's near-term downside risk from an equity market perspective may be limited given the recent correction, whereas the upside on the positive resolution of trade issues and execution of reform initiatives could be significant. We are of the opinion that **China** has the policy tools to manage economic challenges and provide stimulus as it continues with structural reforms. We saw regulators implement a number of measures, including a 1% cut in banks' reserve requirement ratio, an increase in export tax rebates and tax deductions on household income, in October. Moreover, China offers an unparalleled range of investment opportunities as rapid digitalization and growing consumption support growth for companies across different industries. Accordingly, when we look at the valuations and earnings potential of Chinese companies, underlying strength in the Chinese economy and ongoing reform efforts, we remain optimistic for China's long-term potential.

3. Pessimism about future global growth, the US-China trade conflict, rising US interest rates and a strengthening US dollar have led emerging market (EM) investors to switch to more defensive stocks in recent months. October saw **technology-related stocks** record double-digit declines, while the utilities and telecommunication services sectors fared much better. We, however, think the market reaction has been excessive. We believe areas such as e-commerce, digital banking and mobile computing will likely be fundamental drivers of the global economy for years to come. EMs' accelerating internet usage and penetration are likewise hastening opportunities for efficiencies, cost savings and ease of doing business. Promising fields such as artificial intelligence, autonomous driving and the Internet-of-Things continue to attract investment, signaling strong prospects.

Market Performance (MSCI EM Index, USD)
Cumulative Return

Best	Worst
+Brazil (17.8%)	-Mexico (-17.4%)
+Qatar (7.4%)	-Korea (-14.3%)
+United Arab Emirates (-0.4%)	-Colombia (-14.3%)

Sector Performance (MSCI EM Index, USD)
Cumulative Return

Best	Worst
+Utilities (-1.4%)	-Information Technology (-13.6%)
+Financials (-3.7%)	-Health Care (-13.6%)
+Energy (-4.7%)	-Consumer Discretionary (-11.9%)

Currency Performance (vs. USD)
% Change

Best	Worst
+Brazil (7.5%)	-Colombia (-7.8%)
+Turkey (7.2%)	-Mexico (-7.7%)
+Philippines (0.9%)	-Pakistan (-6.2%)

Source: FactSet, one-month period ending 31/10/18.

Outlook

We are of the opinion that the market has been discounting a far more pessimistic scenario than we currently envisage for emerging markets (EMs). EM fundamentals remain strong and we believe that the sell-off provides attractive investment opportunities for long-term investors.

We do not expect contagion from markets such as Turkey and Argentina to spread across the entire EM asset class. The fact is that this is a very different world from past crises: most emerging countries have floating exchange rates, current account surpluses and more favorable debt levels than their developed market peers. Moreover, Turkey accounts for less than 1% of the MSCI Emerging Markets Index, while Argentina is not in the index, and its weighting is expected to be even smaller than Turkey's when it is included in 2019.

A note to our readers: Given the rapid changes that can take place in global markets, it is often difficult to provide up-to-date materials that address the most current situations. The following update is valid only as of 31 October 2018.

In terms of US-China trade concerns, China's dependency on trade has been declining, and trade with the US represents a modest percentage of the Chinese economy. Moreover, intra-EM trade has become more important in recent years, and rising tariffs between the US and China may further pivot focus toward greater regional agreements. For example, tensions between China and Japan have started to ease, resulting in Japanese Prime Minister Shinzo Abe visiting China in October to discuss increased co-operation, the first such trip by a Japanese prime minister since 2011.

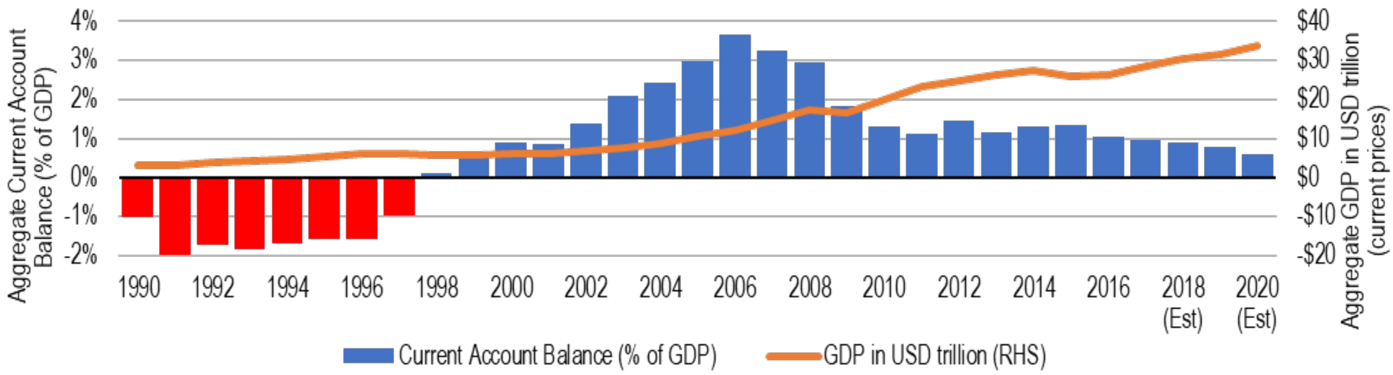
The long-term structural case for EMs continues to center around demographics, consumption and technological advances, and we believe that the best investment results are achieved by buying companies which have sustainable earning power and trade at a discount to their intrinsic worth.

Emerging Markets Key Trends and Developments

A combination of headwinds sent global stocks lower in October, with EM equities ceding more ground than their developed-market (DM) counterparts. Concerns about global economic growth, prospects for major technology companies, US interest rate hikes, and US-China trade tensions curbed investor sentiment. The MSCI Emerging Markets Index fell 8.7% over the month, compared with a 7.3% decline in the MSCI World Index, both in US dollars.

Emerging Markets Aggregate Current Account Balance & GDP Growth

Calendar Year 1990-2020



Sources: IMF, World Economic Outlook Database. As of October 2018. Index-MSCI Emerging Markets Index. Indexes are unmanaged and one cannot invest directly in an index. They do not include fees, expenses or sales charges. There is no assurance that any estimate, forecast or projection will be realized.

The Most Important Moves in Emerging Markets This Month

- Asian stocks registered broad-based losses. South Korea and Taiwan led the way down, as their technology-heavy indexes fell amid a rout in global technology stocks. China's stock market was also among the weakest performers in the region, hampered by slowing domestic economic growth and fears of an escalation in the US-China trade dispute. Measures from the Chinese authorities to support the economy helped stem the market's decline. The Philippines and Indonesia, however, fared relatively better, albeit also ending October in negative territory.

- Latin America was the only EM region to end the month with a positive return, solely because of the strong performance of the Brazilian market. Equity prices rallied on expectations for, and the subsequent victory of, a more market-friendly candidate in presidential elections late in the month as well as appreciation in the Brazilian real. At the other end of the spectrum, Mexico and Colombia recorded double-digit declines. The cancelation of the new Mexico City Airport project and expectations that persistent inflation could result in higher interest rates impacted investor sentiment in Mexico. A decline in oil prices and depreciation in the Colombian peso weighed on the Colombian market.

- Emerging European markets corrected in October, but performed better than their EM peers. Poland, Greece and the Czech Republic fell the most. Eurozone worries weighed on the region in October following fiscal concerns and a credit downgrade in Italy, as well as German Chancellor Angela Merkel's decision not to run for a fifth term. The Russian market also corrected on the back of lower oil prices. A strong appreciation in the Turkish lira partially offset losses in US-dollar terms in that market. In South Africa, stocks in the consumer discretionary, materials and financials sectors declined the most.

- Although frontier markets as a group declined, they outperformed their EM and DM counterparts. Kazakhstan, Lebanon and Sri Lanka were among the top-performing markets, ending the month with positive returns. The Moscow Exchange (MOEX) and Kazakhstan Stock Exchange (KASE) signed a strategic partnership agreement in October, which also included plans for the MOEX to acquire a 20% stake in the KASE. Hopes that a political upheaval in Sri Lanka could result in a more-growth focused government boosted sentiment in that market. Lithuania and Vietnam, however, underperformed.

Regional Outlook

Three-Month Period Ended 30 September 2018

Market	(–) N (+)	Investment Thesis
Asia		Strong macroeconomic fundamentals, but the US-China trade dispute could impact some markets.
China		Uncertainties surrounding the US-China tariff dispute weigh on China's economic outlook. The immediate impact could be limited, but if tariffs ultimately affect the global supply chain of technology products, the longer-term impact on China's growth could be material. The government's easing policy may, however, mitigate the impact but results may be limited given the need for continuation of supply-side reform and deleveraging.
India		Long-term fundamentals including under-penetration, formalization of the informal economy and a stable government remain intact, but near-term earnings challenges lead us to maintain a neutral view on the market.
Indonesia		Economic growth remains steady. However, politics will likely heat up ahead of the legislative and presidential elections in April 2019.
South Korea		Macro indicators remain sound. The geopolitical situation warrants close attention, while concerns about government regulations are growing.
Pakistan		Uncertainty remains, with concerns on a political reshuffle and high current account deficit.
Taiwan		Macroeconomic data remain healthy but inflation may start to rise, pressuring interest rates. While a strong Taiwanese dollar weighed on corporate earnings, recent weakness should ease concerns. The major overhang, however, is the trade dispute between the United States and China. Many Taiwanese companies have production plants in China and could be impacted if the situation worsens.
Thailand		Overall outlook is positive. Economic stability remains strong with continued improvement in economic growth. The upcoming general election could further boost sentiment.
Vietnam		Steady outlook. GDP above 6%, underpinned by resilient domestic demand, rebounding agricultural production and strong export-oriented manufacturing.
Europe		Solid economies with attractive valuations; Turkey remains an outlier.
Czech Republic		Relatively safe market, with an open economy and current account surplus. Do not expect any significant issues unless there is a significant global slowdown.
Hungary		The economy is doing well but structural problems may be accumulating.
Russia		In a stable oil price/ruble environment, domestic names should benefit due to earnings revisions and increased demand. The political situation should remain stable with the next presidential election scheduled for 2024. However, macro risks remain high due to volatile commodity prices and the possibility of additional US/EU sanctions.
Turkey		Weak demand and high cost of funding has resulted in a challenging macroeconomic environment for companies. Non-performing loans are expected to rise in the short-term. A recovery may start after March 2019 elections.

cont'd.

The graphic reflects the views of Franklin Templeton Emerging Markets Equity regarding each region. All viewpoints reflect solely the views and opinions of Franklin Templeton Emerging Markets Equity. Not representative of an actual account or portfolio.

Regional Outlook, continued
Three-Month Period Ended 30 September 2018

Market	(–)	N	(+)	Investment Thesis
Latin America		◆		Solid economic situation. A cyclical rebound is taking place amidst the commodity price recovery, but political uncertainty due to elections in Brazil may result in increased volatility in that market.
Argentina		◆		The US$50 billion package from the IMF has saved the Macri administration from an early departure, but it has not restored investor confidence that could help meet the country's financial requirements for 2018 and 2019. The government was forced to accelerate fiscal consolidation in exchange for an acceleration of disbursements. While the financial plan looks feasible in theory, it seems challenging to implement, politically, despite opposition approval for the 2019 budget.
Brazil			◆	The near-term outlook is challenging in view of 2018 presidential elections, which could bring higher volatility. Our long-term outlook, however, is positive with the new president likely to continue promoting reforms.
Mexico		◆		The conciliatory and prudent speech of President-elect Andrés Manuel López Obrador coupled with the handshake agreement between the United States and Mexico to continue under the guidelines of the former NAFTA have helped contain pressure on the currency and triggered a relief rally in the equities market.
Peru			◆	We expect political noise but believe that it should not deviate Peru from its sustained long-term growth trend.
Middle East		◆		Varied outcomes in different markets—some affected by macro and political factors, others benefiting from higher oil prices, reforms and FTSE/MSCI upgrades.
Kuwait		◆		FTSE upgrade later this year and potential MSCI upgrade to EM status could be positive catalysts for the market. Kuwait's fiscal position appears stronger than its regional peers and, hence, more defensive. A persistent risk is political deadlock, which often leads to slower fiscal reforms and investments.
Qatar		◆		Risks include slowing economic growth, political conflict and deadlock, and continued weak investor appetite.
Saudi Arabia		◆		FTSE and MSCI EM upgrades could be strong catalysts for the market. The country continues to have stable economic growth, while the National Transformation Plan and Vision 2030 is being redrafted to reflect more realistic targets.
United Arab Emirates		◆		Within the region, the UAE is least dependent on oil revenues. Fiscal reforms such as the VAT implementation have been successful. The strong property sector, however, needs to be monitored closely.
Africa		◆		Weaker global outlook impacting some economies; potential remains for improvement going forward, encouraging macro signs.
Egypt		◆		Egypt has taken a committed step toward economic reforms. It is witnessing receding inflation and a strengthening currency.
Kenya		◆		Gross domestic product (GDP) growth could pick up after stalling last year, but credit remains constrained and the International Monetary Fund (IMF) facility review is at risk.
Nigeria			◆	The market is improving from a macro perspective with higher oil production, higher oil price, steadying inflation, and foreign exchange liquidity. However, some investors do have concerns regarding investment into Nigeria given the substantial claims against telecom company, MTN.
South Africa		◆		The outlook is less positive than 3-6 months ago, weighed by a slow recovery and weaker global backdrop and sentiment. Domestically, though, the country should be past the lowest point.

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- **15** years on average of industry experience
- **9** years on average with Franklin Templeton


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