FRANKLIN TEMPLETON

Investment Team Update

15 February 2019

Emerging Markets Race Ahead in January

EMERGING MARKETS INSIGHTS

Three Things We're Thinking About Today

1. As widely expected, the US Federal Reserve (Fed) left its key interest rate unchanged at its January meeting. A change in the Fed's language and tone from its December meeting, indicating patience, signaled a likely pause or even halt in rate hikes. Flexibility in balance sheet normalization was also indicated. Market participants now widely expect one rate hike for 2019, down from two last month, leading market sentiment towards emerging-market (EM) equities and currencies to improve further. Portfolio flows into EMs have also turned positive in recent months, driven by renewed optimism in the asset class. EMs as a whole continue to demonstrate strong economic potential, with floating foreign exchange regimes, current account surpluses and more favorable debt levels than their developed-market (DM) peers.

2. Progress in US-China trade talks, a stronger Chinese renminbi, implementation of supportive policies on the monetary and fiscal fronts as well as stimulus policies aimed at boosting consumption and tourism drove sentiment in Chinese equities in January. While gross domestic product (GDP) growth in China has eased recently, we do not expect a hard landing as long as the government maintains adequate liquidity and close control over the capital account. The economy continued to grow at a robust rate of over 6%, making the country one of the fastest growing major economies in the world. Meanwhile, a shift towards innovation, technology and consumption as primary drivers of growth could support sustainability over the long term. In the interim, however, we maintain a cautious view as a prolonged trade US-China trade dispute could lead to significant volatility. We will continue to monitor the situation and look for attractive investment opportunities in sectors related to health care, consumption and manufacturing upgrades, which over the long term, are less directly impacted by tariff regime changes.

3. The market reacted positively to India's fiscal budget announced on February 1, 2019. While the budget signaled a pause in fiscal consolidation, the lack of major loosening (with acceptable fiscal slippage) and boost to consumption were relatively well received by the market. The Modi government sought to strike a balance between the need to appease lower income and rural populations in the run-up to the national elections in the second quarter, and economic priorities. With the national elections coming up, Indian markets are expected to remain volatile, with the compounding effect from global macro uncertainty. In the longer run, however, we believe the case for investing in India remains strong as fundamentals remain intact. Indian equities are also expected to show resilience to global trade concerns due to less export dependence, a reasonably robust macroeconomic situation and rising domestic liquidity.

Market Performance (MSCI EM Index, USD)
Cumulative Return

Best	Worst
+Turkey (18.0%)	-India (-1.9%)
+Brazil (17.8%)	-Malaysia-EM (1.4%)
+Pakistan (16.4%)	-Taiwan (1.7%)

Sector Performance (MSCI EM Index, USD)
Cumulative Return

Best	Worst
+Consumer Discretionary (13.2%)	-Materials (4.9%)
+Real Estate (10.4%)	-Health Care (5.3%)
+Energy (10.4%)	-Consumer Staples (5.9%)

Currency Performance (vs. USD)
% Change

Best	Worst
+South Africa (8.4%)	-India (-1.8%)
+Brazil (6.4)	-Qatar (0.0%)
+Chile (6.3)	-United Arab Emirates (0.0%)

Source: FactSet, one-month period ended 1/31/19.

Outlook

Investor sentiment in emerging markets continued to improve in January, supported by a dovish US Federal Reserve and hopes for the US and China to reach a trade deal by March, when higher US tariffs on Chinese goods are poised to set in.

We believe confidence in EMs could strengthen further based on several factors: economic growth differentials between EMs and DMs are widening in the former's favor, EM currencies appear undervalued despite balance of payment surpluses in many markets, ongoing reforms, a robust EM earnings outlook and undemanding valuations.

EMs are currently trading at a significant discount to DMs, providing long-term investors with an attractive investment opportunity. As of end-January, the MSCI EM Index traded at a forward price-to-earnings (P/E) ratio of 11.4x and a price-to-book value (P/BV) of 1.6x, while DMs, as represented by the MSCI World Index had a forward P/E of 14.5 and P/BV of 2.3x.[1]

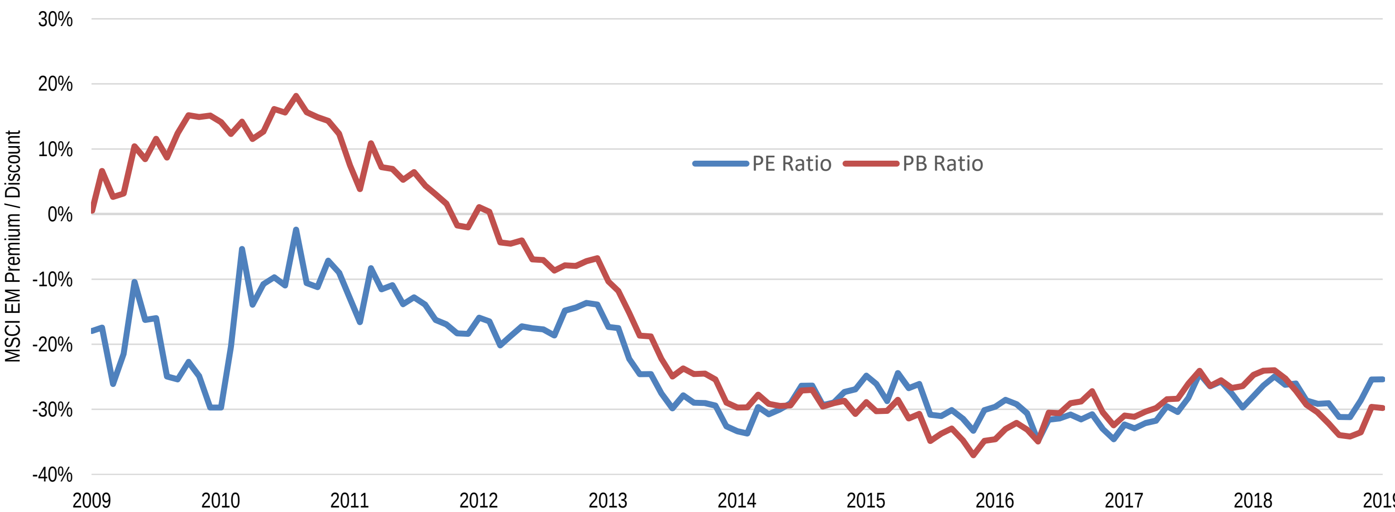
We are particularly upbeat about growth prospects for the information technology and consumer-related sectors. The growing adoption of technology and growth of digital platforms have helped create new goods and services for consumers across EMs, and at the same time creating growth opportunities for many EM companies and investors. Additionally, with most young people (those under the age of 30) in the world living in EMs, we believe there are tremendous opportunities for businesses that can effectively capture and serve this target market.

Emerging Markets Key Trends and Developments

Global stock markets began 2019 on a strong note, driven by optimism around US-China trade negotiations and hopes for a prolonged pause in US interest rate hikes. EM equities benefitted from domestic currency strength and robust portfolio inflows to finish January ahead of their DM counterparts. The MSCI Emerging Markets Index rose 8.8% over the month, compared with a 7.8% return in the MSCI World Index, both in US dollars.

Valuation: MSCI Index vs. MSCI World Index

31 January 2008 – 31 January 2019



Source: MSCI. As of January 31, 2019. Indexes are unmanaged, and one cannot invest directly in an index. They do not include fees, expenses or sales charges.

The Most Important Moves in Emerging Markets This Quarter

- Asian equities rebounded, aided by strong returns in Pakistan, China and South Korea. China's stock market rallied, thanks to signs of progress in US-China trade talks and fresh policies to counter slower economic growth. South Korea's index rose as technology heavyweights surged on the back of improved investor sentiment. Conversely, stocks in India declined. Expectations of increased government spending ahead of a general election this year raised concerns over the country's fiscal deficit.

- In Latin America, Brazil, Colombia and Chile were among the leading performers, ending January with double-digit gains, on the back of higher commodity prices and stronger domestic currencies. Positive expectations from the new administration further supported returns in Brazil. While Peru and Mexico recorded positive returns, their equity markets lagged performance of their regional peers. Concerns that severe fuel shortages, resulting from the government's efforts to combat fuel and gasoline theft, could impact business operations weighed on sentiment in Mexican equities.

- Equity markets in Emerging Europe also gained ground with Turkey and Russia leading the way. Higher oil prices and appreciation in the Russian ruble drove returns in that market. The Czech Republic, Hungary and Poland also posted solid gains but underperformed their regional counterparts. The South African rand was among the best-performing EM currencies in January, driving equity gains in US-dollar terms. Higher metal prices drove returns in steel and platinum companies, while weaker-than-expected Christmas sales data and profit warnings from a number of companies weighed on retailers in South Africa.

- Frontier markets ended the month with positive returns, but fared worse than their global counterparts. Argentina and Kenya led returns, although Vietnam and Kuwait also recorded gains. Romania and Nigeria, however, recorded declines. Appreciation in the Argentine peso and easing inflation supported sentiment in that market. Concerns surrounding the upcoming presidential elections in Nigeria weighed on investor confidence, while the government's decision to implement a levy on the financial sector in Romania worried investors.

1. Source: MSCI, Factset as of 31 January 2019.

Regional Outlook
Three-Month Period Ended 31 December 2018

Market	(–) N (+)	Investment Thesis
Asia		Solid macroeconomic fundamentals, but the US-China trade dispute and slowing global growth could impact some markets.
China		The negative outlook is mainly driven by the uncertainties surrounding the US-China trade dispute. As the US cycle matures and global growth momentum slows, China's GDP growth is expected to ease to 6.0-6.1% in 2019. While the trade dispute and Huawei incident could lead to weaker exports, government stimulus and tax cuts are expected to support domestic consumption and fixed asset investment.
India		Long-term fundamentals include under-penetration, formalization of economy and a stable government remain intact. However, the improving current account deficit and easing inflationary pressure along with a strong possibility of an improvement in corporate earnings are offset by higher-than-average valuations and incremental political uncertainty.
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. However, concerns about government regulations are growing, while the geopolitical situation warrants close attention.
Pakistan		Uncertainty remains with concerns on a political reshuffle and high current account deficit.
Taiwan		The major overhang is the US-China trade dispute. Many Taiwanese companies have production plants in China and could be impacted if the situation worsens. Weaker-than-expected demand for information technology-related products is also worrying. Inflation has been manageable, limiting pressure on interest rates.
Thailand		Economic stability remains strong, but growth outlook is moderate. The upcoming general election should support near-term sentiment, but outlook could be challenging post-election.
Vietnam		GDP remains above 6%, underpinned by resilient domestic demand and strong export-oriented manufacturing. US-China trade tariff issue is an uncertain risk.
Europe		Solid economies with attractive valuations; Turkey remains an outlier.
Czech Republic		Relatively safe EM, 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 seem to be accumulating. However, the near-term outlook should not be impacted.
Russia		In a stable oil price/ruble environment, domestic names should benefit from 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 the 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 31 December 2018

Market	(–) N (+)	Investment Thesis
Latin America	– +	Solid economic situation in most economies. Improving political situations in markets such as Brazil and Peru, but some concerns remain in Mexico and Argentina.
Argentina	– +	The US$57 billion IMF Stand-By Arrangement should meet the government's financing needs until end-2019 but failed to lower sovereign spreads to a level that would allow Argentina to return to the international financial markets. Meeting the government's 2020-2024 financial needs, however, look challenging in view of the US$35 billion average annual requirement. The market believes that the victory of the opposition in 2019's presidential election could trigger a debt renegotiation.
Brazil	– +	The new government's emphasis on implementing ambitious economic reforms could provide a basis for higher economic growth and a better business environment for companies.
Mexico	– +	We expect volatility in financial markets to continue as uncertainty about how the new Mexican administration will run the country persists.
Peru	– +	President Vizcarra's approval ratings have continued to consolidate at higher levels, while Fujimorism seems to have lost appeal to the masses. We expect political noise but believe that it should not cause Peru to deviate from its sustained long-term growth trend.
Middle East	– +	Varied outcomes in different markets—some affected by macro and political factors, others benefiting from reforms and FTSE/MSCI upgrades.
Kuwait	– +	FTSE upgrade 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 see stable economic growth, while the National Transformation plan and Vision 2030 is to be 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 value-added tax 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 macroeconomic signs.
Egypt	– +	Egypt has made a committed step toward economic reforms. It is witnessing receding inflation and a strengthening currency.
Kenya	– +	GDP growth could pick up after stalling last year, but credit remains constrained and the IMF facility review is at risk.
Nigeria	– +	The market is improving from a macro perspective with steadying inflation and foreign exchange liquidity. However, there are concerns with regard to investment in Nigeria given the substantial claims against telecom company MTN.
South Africa	– +	The outlook remains muted, although signs of improvement were evident in the third-quarter GDP data. While still weighed down by a slow recovery and weaker global backdrop and sentiment, domestically the country should be past the lowest point.

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FRANKLIN TEMPLETON EMERGING MARKETS EQUITY

Local Knowledge, Global Reach

In a sea of overlooked and under-researched companies, there's no substitute for local market knowledge. Our on-the-ground investment team of over 80 portfolio managers and analysts across nearly 20 countries distinguishes Franklin Templeton Emerging Markets Equity from the crowd. Investors benefit from our networks of local business contacts, access to in-person company visits and real time response to local market events.

Our global reach through Franklin Templeton Investments provides access to sophisticated risk management and trading resources. Portfolio management collaborates closely with the Investment Risk Management Group, which provides detailed risk analytics to complement the team's assessment of risk exposures.

- **85+** portfolio managers and research analysts
- **15** years on average of industry experience
- **9** years on average with Franklin Templeton

A FEW WORDS ABOUT RISK

Special risks are associated with foreign investing, including currency fluctuations, economic instability and political developments. Investments in emerging markets 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. To the extent a fund focuses on particular countries, regions, industries, sectors or types of investment from time to time, it may be subject to greater risks of adverse developments in such areas of focus than a fund that invests in a wider variety of countries, regions, industries, sectors or investments. Investing in smaller company securities that may have limited liquidity involves additional risks, such as relatively small revenues, limited product lines and small market share. Historically, these stocks have exhibited greater price volatility than larger company stocks, especially over the short term.

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 January 2019.

The significant growth potential offered by emerging markets remains accompanied by heightened risks when compared to developed markets, including risks related to market and currency volatility, adverse social and political developments, and the relatively small size and lesser liquidity of these markets.

The information provided is not a complete analysis of every material fact respecting any country, industry, security or investment. Opinions expressed are those of the portfolio managers and are subject to change without notice. Statements of fact have been obtained from sources considered reliable. Because market and economic conditions are subject to rapid change, analyses are valid only as of 31 January 2019. Opinions are intended to provide insight as to how the portfolio managers analyze securities and are not intended as individual investment advice. Performance information is historical and should not be considered predictive of future results. All securities investments fluctuate and involve risks.

Investors should carefully consider a fund's investment goals, risks, charges, and expenses before investing. To obtain a summary prospectus and/or prospectus, which contains this and other information, talk to your financial advisor, call us at (800) DIAL BEN®/342-5236, or visit ***franklintempleton.com****. Please carefully read the prospectus before you invest or send money.*

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