FRANKLIN TEMPLETON

Investment Team Update
September 30, 2020

Emerging Markets Insights

Investors Turn Cautious in September after a Strong Start to the Quarter

Three Things We're Thinking About Today

1. **Brazil** has been among the hardest hit by the COVID-19 pandemic, just behind the United States and India in the number of reported cases. However, we have started to see the number of new cases in Brazil start to decline. Ironically, we believe that the government's decision against implementing a country-wide lockdown at the onset of the pandemic has reduced the likelihood of a second wave. Heavy government spending and monetary policy easing have helped bring some stability to the economy. Moreover, Brazil has continued to implement key reforms despite political noise. In terms of investment opportunities, we continue to favor the financials sector, especially companies with strong capital market exposure. Interestingly, Brazil's stock exchange itself has a strong sustainability agenda, while environmental, social and governance (ESG) principles are not only implemented within the exchange itself, but also promoted in the Brazilian stock market broadly. E-commerce is another exciting investment theme, with several large players competing in the online space. As in other countries, the COVID-19 crisis has accelerated the adoption of internet-based retailing in Brazil. Despite continued uncertainties, our view on Brazilian equities is generally positive.

2. The COVID-19 pandemic has underscored the importance of **health care in China**, reinforcing existing structural trends that could drive a new wave of innovation in the country. Multiple factors are propelling domestic drug and medical device development including rising health care demand, an aging population, growing lifestyle diseases and rising income, coupled with government efforts to strengthen the health care system. In addition, the growing numbers of overseas-educated Chinese scientists and entrepreneurs returning to the country constitute an abundant pool of homegrown talent. We see greater long-term potential in innovative drug makers with strong portfolios or pipelines of treatments, compared with generics companies that are likely to face price pressures from government reforms. Some Chinese biotech firms have shown remarkable speed in bringing novel treatments to market. Companies in the pharmaceutical outsourcing industry also show promise. Meanwhile, we also see examples of innovation in medical equipment makers—leading domestic suppliers, which already have a cost advantage over foreign competitors, whose growth could be encouraged on the back of government policies supporting localization. We think these companies reflect a new breed of innovative enterprises that could transform health care outcomes in the years ahead. Together with flourishing capital markets, favorable policies and motivated talent, a vibrant ecosystem is potentially taking shape.

3. **Company engagement** remains a crucial part of emerging market (EM) investing. Bringing about better corporate behavior and a better understanding of companies' responsibilities toward all stakeholders are efforts we continue to push in our stewardship of client capital. The tone of engagement in EMs has shifted in recent years: companies that formerly took a narrow, hard-nosed approach to returns are adopting more accommodative measures. In countries such as South Korea, South Africa and Brazil, companies are placing more emphasis on ESG issues. We have seen leading companies in South Korea publicly apologize for governance missteps

Market Performance (MSCI EM Index, USD)
Cumulative Return

Best	Worst
Taiwan (27.9%)	Thailand (-12.2%)
India (23.0%)	Turkey (-9.4%)
China (22.7%)	Hungary (-8.7%)

Sector Performance (MSCI EM Index, USD)
Cumulative Return

Best	Worst
Consumer Discretionary (37.1%)	Utilities (-4.3%)
Information Technology (33.8%)	Energy (3.6%)
Health Care (18.5%)	Financials (3.8%)

Currency Performance (MSCI EM Index, USD)
% Change

Best	Worst
Mexico (4.7%)	Turkey (-11.0%)
Greece (4.4%)	Russia (-8.2%)
South Africa (4.2+6%)	Argentina (-7.5%)

Source: FactSet, three-month period ending 09/30/20.

and manage their balance sheets more effectively through returning capital to shareholders. ESG reporting has become mandatory in some countries, a trend we expect to continue elsewhere. The ESG conversation is changing further amid the COVID-19 pandemic, with a greater focus on the social impact of policies. Many governments are supporting jobs, while companies are more cognizant of the reputational risks of layoffs. ESG has become more important, with companies considering it critical to sustainable business performance. In our view, this “delta” of improving ESG in EMs is a further tailwind supporting the secular outlook for the asset class as the world emerges from this crisis.

Outlook

The market had expectations for greater normality into the final quarter of 2020, but with rising COVID-19 cases in Europe and select countries globally, it is evident the virus will persist. As a result, policymaking looks to remain reactive. A silver lining is that these countries have not seen a corresponding jump in mortalities, reflecting improved treatments and wider testing to reveal asymptomatic cases. Despite one of the most stringent and comprehensive lockdowns globally, India could not prevent a late surge in COVID-19 cases and has surpassed Brazil as the country with the second-highest number of cases in the world, behind the United States. However, given that mortality has been contained with daily deaths declining markedly since the peak, the Indian economy continues to reopen despite the surge in cases.

We expect a continuation of the current political, economic and market environment in EMs until a vaccine is widely dispensed or herd immunity achieved, with results and outcomes varying widely by country. In these circumstances, a recovery is likely to be far shallower (taking far longer) and volatile (in response to stop-start policy) than the steep declines earlier in the year. Governments have already spent enormous amounts of money, but many businesses continue to shut down as lockdowns and other policies restructure economies.

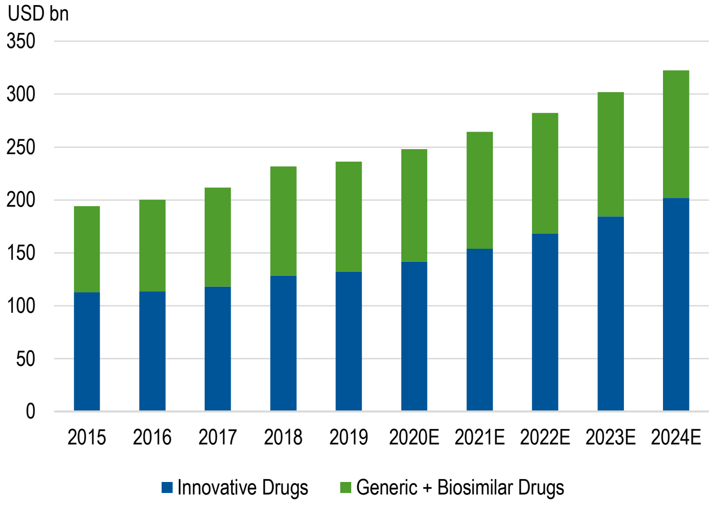
US-China relations have been steadily deteriorating and the political jostling in the lead up to the US presidential election could result in more noise and negative policy developments in the interim. Market volatility could continue, especially if the election results are disputed. In any event, we expect both US political candidates to maintain pressure on China. We also expect the ongoing US-China trade and technology conflict to place continued pressure on supply chains, resulting in more localization and reshoring.

The information technology and communications services sectors have been exceptionally resilient, a trend we expect to continue amid the current environment. We expect EM leadership and growth to continue in various areas such as semiconductors, online gaming and fifth-generation wireless technology (5G) deployment.

Emerging Markets Key Trends and Developments

EM equities rose over a volatile quarter and pulled ahead of developed market stocks. Post-lockdown economic upturns, continued policy dovishness, and progress in coronavirus vaccine trials fueled an initial rally, but it unraveled amid fresh COVID-19 outbreaks and heightened US-China tensions ahead of the US presidential election. EM currencies broadly strengthened against the US dollar. The MSCI Emerging Markets Index increased 9.7% during the quarter, while the MSCI World Index returned 8.0%, both in US dollars.[1]

China’s Pharmaceutical Market is Expanding
2015–2024E



Source: Franklin Templeton Emerging Markets Group, Frost & Sullivan.

The Most Important Moves in Emerging Markets in the Third Quarter of 2020

- Emerging Asian equities outshone broader EMs with a sharp advance over the quarter. Markets in Taiwan, India, South Korea and China soared on the back of strong investor interest in technology heavyweights. In India, better-than-expected corporate results also cushioned the market against COVID-19's sustained spread. China's economic recovery broadened, though escalating US restrictions against Chinese technology companies sparked caution. Bucking the regional uptrend, stocks in Thailand, Indonesia and the Philippines fell. Cabinet resignations and anti-government protests in Thailand fed political uncertainty. Indonesia reintroduced mobility restrictions in its capital to combat rising COVID-19 infections.
- Latin American equities saw broad declines for the quarter despite a strong July, partly due to weaker domestic currencies. Political noise and worse-than-expected second-quarter gross domestic product (GDP) data weighed on sentiment in the Brazilian market. The government also unveiled the first phase of its administrative reform and extended monthly emergency aid to support those impacted by lockdown measures, while the central bank lowered its key interest rate to a record low of 2.0%. Mexico, however, ended

the quarter with positive returns, largely due to a stronger peso. The Central Bank of Mexico also cut its key interest rate by 0.75%, bringing borrowing costs to their lowest level in four years. A gradual resumption of economic activity and a recovery in business expectations supported confidence in Peruvian equities.

- In the Europe, Middle East and Africa region, European markets underperformed their Middle Eastern and African peers as a resurgence in new COVID-19 cases led to a tightening of quarantine measures in several economies in Europe. Lower oil prices, geopolitical worries and a depreciation in the ruble offset the development of a COVID-19 vaccine and better-than-expected second-quarter GDP data to push Russian equities lower. Elsewhere, the South African government continued to ease COVID-19 restrictions, opening the country for domestic travel, with plans for international travel to resume in October. The central bank cut its key interest rate by 0.25% to a record low of 3.5% in July before leaving the rate unchanged at its September meeting.

Regional Outlook

Three-Month Period Ended September 30, 2020

Market	– Neutral +	Investment Thesis
Emerging Asia		Most economies are in the process of easing quarantine measures and returning to normalcy. However, weakness in the global economy weighs on some economies which are more sensitive to trade. Return of US-China tensions will also play a role.
China		Economic conditions are expected to remain weak and patchy even if COVID-19 stabilizes, as it remains a global issue. However, the government policy response will likely soften the impact. It seems that China will probably be the first to recover, barring any new waves. In general, we believe China will most likely emerge stronger from this crisis.
India		Long-term fundamentals including under-penetration, formalization of the economy and a stable government remain intact. However, the structurally constrained inflation and optionality of improving corporate earnings are offset by slowing economic growth and earnings cuts.
Indonesia		The 12-month outlook remains uncertain. The government has been rushing to reopen the economy despite increasing COVID-19 cases and fatalities. COVID-19 containment efforts in Indonesia are among the weakest in the ASEAN region, while the government's stimulus program rollout has also been slow and ineffective.
South Korea		Macro indicators have been deteriorating due to the COVID-19 pandemic; but we expect the situation to normalize once it dissipates. However, concerns about government regulations are growing, and geopolitical tension with North Korea is escalating, warranting close attention.
Taiwan		The near-term outlook remains negative as the COVID-19 outbreak has slowed down the global economy. Although the United States and China reached a partial trade agreement, we expect trade issues between the two countries to continue. The Huawei ban also disrupts the supply chain, where many Taiwanese technology companies are engaged. The medium- to longer-term outlook, however, remains positive, given 5G deployment and the acceleration of production relocation from China.
Thailand		Although the near-term domestic outlook appears more positive than its ASEAN peers as the economy reopens, the overall outlook is negative due to: i) a weak global trade outlook; ii) a decline in tourist arrivals; iii) lack of private investments to spur domestic consumption; iv) political uncertainties.
Latin America		Lockdown measures following the spread of COVID-19 across the region impacted the informal segments of economies in the region. A gradual lifting of mobility restrictions should help the situation. However, political uncertainty and concerns of weak global demand continue to weigh on the region's outlook.
Brazil		The COVID-19 pandemic is expected to have a lasting impact on Brazil's economy. The speed and strength of recovery will depend on the government's resumption of its ambitious economic reforms, which should provide the basis for higher long-term economic growth and a better business environment for companies. Record-low interest rates should continue driving domestic flows to equities.
Mexico		Mexico has an open economy (over a third of GDP) heavily exposed to the United States (over 70% of exports go there). The length of disruptions from flow restrictions to contain the COVID-19 spread will determine the level of the slowdown. Additionally, Mexico has a large level of informal economy, which will suffer from restrictions to services impacted by quarantine.
Peru		Political volatility has been hindering Peru´s economic recovery, shifting focus away from government spending and infrastructure investment. Nevertheless, business confidence increased to 38.0 in August, up from July's 35.0, as firms continued to react positively to easing lockdown measures in recent months. However, the indicator remains well below the 50-point threshold that separates pessimism from optimism among firms. Firms reported broad-based gains in August, with views regarding their sector, future demand for their products and their financial situation all improving. Peru's copper production rebounded to ~100% of normalized levels in July vs ~60% in May and ~90% in June.

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

Regional Outlook

Three-Month Period Ended September 30, 2020

Market	– Neutral +	Investment Thesis
Emerging Europe		Easing lockdown measures have led to new waves of COVID-19 cases across Europe, prompting an increase in social distancing measures. Negative growth is expected for 2020, as export-dependent economies remain under pressure.
Czech Republic		While the Czech Republic is one of the most stable countries in Eastern Europe and emerging markets, it has a shallow capital market and limited investment opportunities. Its economy is integrated with the export-driven German economy; thus, a recovery is also dependent on that market, which is currently challenged.
Hungary		As an open economy with high exports, Hungary's economy is integrated with the export-driven German economy, thus a recovery is also dependent on that market, which is currently challenged.
Poland		Policies including increased protectionism, regulations and taxes are concerning. Economically, 2020 GDP contraction is expected to be among the mildest in the European Union.
Russia		In a stable oil price/ruble environment, companies should benefit from earnings revisions and improved dividend yields. The political situation should remain stable with the next presidential election scheduled for 2024. Macro risks, however, remain high due to volatile commodity prices, the US-China trade conflict and the possibility of additional US/EU sanctions. Overall, we maintain a positive view as historically low interest rates in Russia should increase local investment in the stock market. However, concerns about COVID-19 continue to impact market sentiment.
The Middle East		The region's outlook remains tied to a recovery in oil prices and developments related to the COVID-19 pandemic. High reserves provide some economies with some protection.
Kuwait		Kuwait has a strong fiscal position but a delay in reform and issuance of debt law could erode government finances. Non-oil GDP is somewhat shielded, as most Kuwaitis are employed by the government. MSCI EM Index inclusion at the end of November should support large-cap companies.
Qatar		Activity related to FIFA 2022 preparations and LNG production expansion present a case for growth and earnings uptick for the next 3-4 years. High sovereign reserves and a low oil budget breakeven point offer Qatar solid stability in times of downturn.
Saudi Arabia		The outlook is challenging and remains anchored to a recovery in oil prices and developments related to COVID-19. Substantial foreign exchange reserves and public investment fund (PIF) assets provide some comfort.
UAE		The equity market is cheaper than its MENA peers, but the macro outlook is poor. Moreover, the equity market is already well-owned by foreigners, making it hard to see a re-rating in the near-term.
Africa		Weaker economic environment and politics impacting some economies; potential remains for improvement over the longer term.
Egypt		We expect growth to remain positive and recover gradually, while discretionary spending could remain under pressure. We see receding inflation with little risk of interest-rate increases, and expect the currency to remain largely stable. Being a major source of foreign currency, a longer disruption to tourism is a key risk going forward.
Kenya		The outlook is starting to improve with what appears to be a faster recovery in economic activity.
Nigeria		The risk of further currency weakness remains high, while a weak political and macroeconomic environment creates a challenging environment for stocks.
South Africa		The outlook remains negative. Post COVID-19 shows a longer recovery, with the market waiting on clear guidelines on the budget deficit and the ability of government to address the weak economic growth.

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Franklin Templeton Emerging Markets Equity

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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.

- **80+** portfolio managers and research analysts
- **16** years on average of industry experience
- **8** years on average with Franklin Templeton

1. Source: MSCI. The MSCI Emerging Markets Index captures large-and mid-cap representation across 24 emerging-market countries. The MSCI World Index captures large-and mid-cap performance across 23 developed markets. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or guarantee of future results.** MSCI makes no warranties and shall have no liability with respect to any MSCI data reproduced herein. No further redistribution or use is permitted. This report is not prepared or endorsed by MSCI. Important data provider notices and terms available at www.franklintempletondatasources.com.

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