FRANKLIN TEMPLETON INVESTMENTS

July 2017

Templeton Emerging Markets Investment Trust: Investment Update

Summary of webinar comments, 29 June 2017

SUMMARY

- Despite some volatility, emerging markets are providing interesting investment opportunities.
- Emerging market economic indicators remain supportive of continued growth.
- TEMIT is continuing to look at the technology and consumer sectors as key themes.

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Templeton Emerging Markets Investment Trust

Emerging Markets in 2017

The situation in emerging markets can always be described as being fairly volatile, so there's never ever a quiet week. The noise and developments that we are currently focusing on revolve around some of the structural changes that have been widely covered in the press, namely A-shares in China are going to be included in the MSCI Index. There's a lot of hype about it, despite the fact that it’s less than 1% of the index, although I guess it’s more about the direction than about these absolute figures. Apart from that, there's once again a lot of turmoil that we see in Brazil with the legal proceedings against Temer, who was involved in the “Car Wash” scandal. On the more positive side, over in India there are very good developments, at least from an asset standpoint, with regards to the tax reform – a very, very complicated affair that they're trying to tackle. Still there is too much bureaucracy there, sometimes multi-layered depending on the state, and the Government is really trying to clean this up and make India more competitive. Part of the reason is the fact that Pakistan is doing very, very well with the China-Pakistan Energy Corridor (CPEC) programme, which was a $46 billion investment programme, so the ‘neighbourhood’ is trying to stay competitive and I think that India is partially affected by that.

Emerging Europe

Turning again to the negative side, the European Union further extended the sanctions against Russia. That followed the previous sanction extension by the US, which is something we are watching carefully and which has an effect on prices and currencies. Furthermore, the oil price has been somewhat weak in the last couple of weeks. Last but not least, the remaining bit of uncertainty is still related to US policy and trade barriers or higher costs, which could come from a tougher stance on trade by the US.

The good news is that in this period of volatility, emerging markets look more robust than they have in the past and the robustness is related to the time they have had to do their homework and to improve both the profile of public finances and also private sector leverage, which has come down quite significantly.

Currencies

We had a very dramatic depreciation of emerging markets currencies in 2015, which was as usual followed by a return to historic averages. Nevertheless, if you look at the group of emerging markets currencies against the US dollar over the last 10 years, the emerging market currencies are still trading very near to an all-time low. That means that there is still a lot of both perceived and factual risk that is priced into these currency rates, and that makes it attractive for any foreign investor.

The current account balance of emerging markets in general has improved quite a bit and we positioned the portfolio to specifically benefit from these conditions. There has been import substitution in many of the emerging markets; from Russia, where you see a preference for locally produced goods, to Brazil where, again, more expensive imported goods have been replaced by locally produced goods. That’s why we bought M. Dias Branco, a local pasta and biscuit producer, which is doing phenomenally well despite the fact that the country is in such a difficult overall economic situation.

Low Debt Levels

Looking at debt, one of the factors that we have been talking about for quite some time, but now more important than maybe ever before – public debt in emerging markets is extremely low compared to developed markets and also in historic terms. It means that they can weather the storm of global uncertainty much better and also that they are less dependent on refinancing vehicles in US dollar, euro or any other hard currency.

They are more able to source financing locally than ever before – a function of low interest rates and fairly well managed inflation. This is allowing them to spend money on more productive things as opposed to just servicing interest. The same goes for the private sector. Private sector debt in emerging markets stands at an all-time low on a relative basis. This doesn't mean that all countries have that profile – China stands out as a country with a fairly high proportion of debt to GDP – reaching 250%. The big difference is that the debt in China is all local debt as opposed to external debt. Couple that with the fact that China has very high foreign currency reserves, a very high positive trade account and is, at the end of the day, a managed economy with low inflation and controlled interest rates, means that the debt is manageable for China. Therefore, we do not think that there could be a situation where the debt could cause a dramatic destabilisation of the Chinese economy.

Commodities

Although commodities as a group are still trading at very low levels historically, earnings in emerging markets are gradually improving and that is partially because the repair phase in emerging markets is behind us and they are back into the investment mode. Exports are strong, future industrial production numbers look very decent and corporate earnings are coming back to their previous growth trajectory. We expect this strong trend to continue for some time. Return on Equity (ROE) is also improving, so profitability in emerging markets is improving across all geographies, driving prices higher.

Looking more closely at commodity prices, while there has been quite a bit of improvement we don't think that there will be another immediate spike as we've seen in the previous decade. We are thinking and calculating that prices will stay more range-bound. We expect more stability in prices with less speculation. The thing to watch is the involvement of ETFs in the commodity market as that could cause big impacts on prices. Overall, we think it will be a sideways market because the situation in China is healthier and there is less speculative buying. Demand in the oil market is seeing only about 1-1.5% growth every year but, as the prices increase, production is immediately reacting to that and the US, who are now one of the big players, are typically then opening up the floodgates and increasing supply to the market, keeping prices under control. We think that this stability in commodity prices is very good for emerging markets overall.

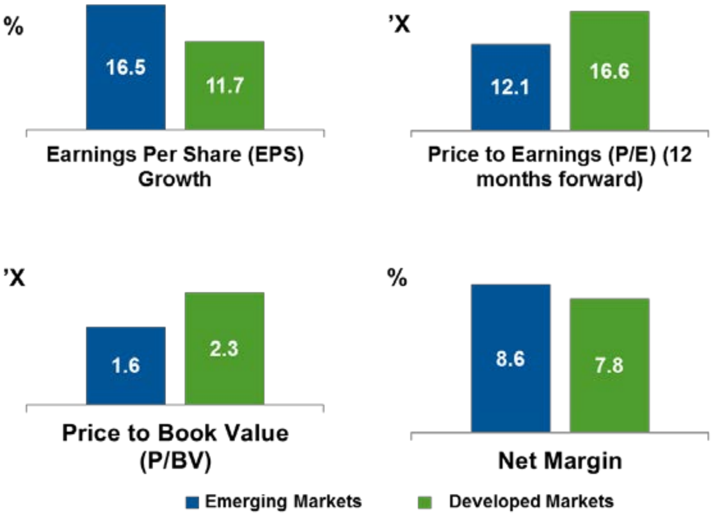
Valuation

Valuations are at the core of our investment philosophy and process. Emerging markets remain undervalued by a very wide margin as seen on the following chart. The spread between developed markets (particularly the US) and emerging markets valuations is at an all-time high; in other words, the market is trading at an all-time low compared to their developed market bigger brothers. As earnings are still recovering, the valuations will continue to stay low. Also on the price-to-book level, we are seeing low valuations, though margins are higher and improving in emerging markets as mentioned earlier.

Importantly, we have seen that emerging market earnings profiles have diversified and changed quite a bit with companies moving into new geographies, new products and services. They have more diversified and, to some degree, more defensive business models than they used to have. A big aspect is M&A activity – Chinese companies have been very active in spending; about $200 billion in acquisitions globally over the last 12 months. They are purchasing companies all over the place, not just in Africa, but also in America, Germany and England. They're buying skills and knowledge, and that is a theme that

Valuations

Emerging Markets Trading at a Discount



For illustrative and discussion purposes only. Data as at 31/03/2017. Source: MSCI; Developed Markets as represented by the MSCI World Index; Emerging Markets as represented by MSCI Emerging Markets Index; There is no assurance that any projection, estimate or forecast will be realised.

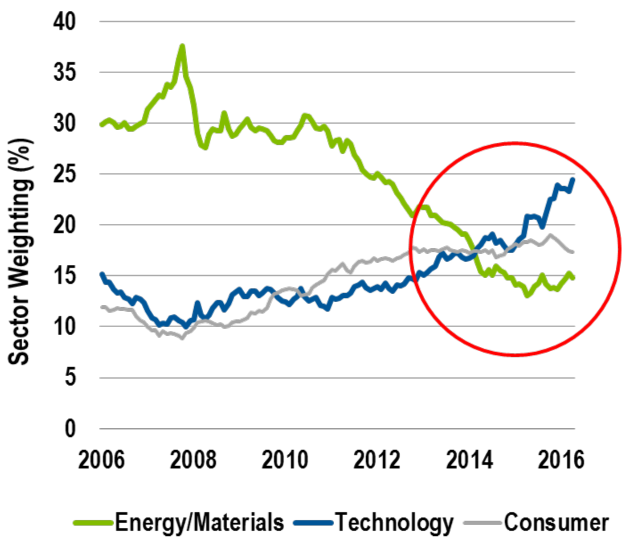
we continue to see. We also see this affecting some of the smaller emerging- and frontier-markets where we see some companies becoming takeover targets.

Investment Themes

One of the most important topics we have been following in the last two-to-three years is technology. As illustrated in the chart below, emerging markets are now dominated by the technology sector, not only in China, but also, for example, Korea, Taiwan, Hong Kong and Singapore. It is not just an Asian subject – in Latin America, we see similar developments where ecommerce is taking off. In Russia we have invested in a company which is, essentially, the Russian version of Google. Technology is really the name of the investment story of emerging markets going forward, and we see that it is not just happening in banking and ecommerce, but also on the hardware side. For example, automation is a big theme in China and component suppliers to the automobile industry are benefitting.

The Growing Influence of Technology in Emerging Markets

October 1996 – March 2017



For illustrative and discussion purposes only. Source: MSCI, FactSet, as of April 2017.

Surging local knowledge is leading to local 'champions' competing globally with their concepts, software and hardware. About half of global patent registration is now in emerging markets, so the ideas are coming from emerging markets and new business models are being established. We have good exposure to the sector at about 29% diversified across geographies, countries and business models. China, now, is about 20% of the global internet consumption, the biggest in the world.

Investment process and portfolio

The process and the philosophy remain unchanged and very benchmark agnostic. The very large size of Exchange Traded Funds (ETFs) that are investing in emerging markets and becoming significant shareholders in companies presents a hidden risk, as the shareholder structure becomes less diversified and more dominated by those ETFs. This means that they are impacting prices when they all buy, and it will be a similar impact when they all sell. So, as active investors, we look for opportunities not affected by these trades. In other words, non-index companies which are not owned by any ETFs. We have a strong preference for those because we think it is a way of managing risk going forward and, typically, we prefer a more diversified and healthy ownership structure. One of the strongest portfolio positions here is the fact that we do not have any meaningful exposure to the Chinese financial sector – in fact the financial sector overall is one of our biggest underweights and one of the biggest areas where the ETFs are holding positions.

We have a bias to mid-cap stocks. This is where we have seen most of the fastest growing opportunities and maybe some of the most innovative firms. We still hold many very attractive large-caps – about half the portfolio – but around 38% of the current portfolio is in small and mid-caps.

We have not compromised the value approach but it is being redefined as we have to be able to value companies in the technology sector. Our technology team which we established two years ago helps us to understand these companies and to source ideas. They are employing sophisticated valuation techniques that have improved our understanding of companies in the sector. Of course, the long-term horizon is key and we resolutely remain bottom-up stock pickers.

Geographies

In terms of the country positions, we reduced exposure to China/Hong Kong and increased South Korea; one of the strongest performing markets again this year. Taiwan was also one of the biggest increases in the portfolio. In Brazil we reshaped the positioning quite dramatically, specifically towards the mid and small-cap segment, taking some profits from banks. A recent purchase was a local Brazilian insurance broker, uncovered by our team in Brazil. The company has a very dynamic team with an attractive exclusivity distribution agreement with the largest Brazilian public bank. Furthermore, they are catering to a market that is just beginning to be developed. The insurance sector in Brazil is in its nascency, and we find that very attractive. It is a small company and a new addition to the portfolio. We have added exposure to Russia. Russia helped us a lot last year and, whilst this year has been volatile, we remain firm on our positions there, especially in the technology sector. We think commodity prices will stay volatile, but the beauty of the Russian oil companies is that they actually make more money when the oil price falls, as they have a very complex tax regime, which ensures that as the oil price increases, the net profit of the oil companies is actually reducing. At the same time, they have huge cost competitiveness and pay good yields of around 5-6%. South Africa has seen a slight increase, whereas Thailand is one of the big decreases as we reduced exposure to the Thai baht and the Thai economy overall.

Sectors

TEMIT Positioning - Sectors
as at 31 May 2017

Sector	TEMIT (% of Total)	MSCI Emerging Markets Index (% of Total)
Information Technology	29.6	25.6
Financials	22.4	23.7
Consumer Discretionary	22.3	10.9
Consumer Staples	8.3	7.0
Energy	8.1	6.8
Materials	6.3	7.1
Industrials	3.5	5.8
Health Care	1.9	2.3
Real Estate	0.6	2.6
Utilities	0.3	2.6
Telecommunication Services	0.2	5.5

Weightings as percent of total including cash. Percentage may not equal 100% due to rounding. Information is historical and may not reflect current or future portfolio characteristics. All portfolio holdings are subject to change. Indices are unmanaged and one cannot invest directly in an index.

In sector terms, information technology has been one of the biggest increases, partially driven by recent strong performance in underlying shares. I think we really have a very well diversified rock-solid group of companies that gives us exposure to the semiconductor space and the most skilful suppliers of sophisticated goods to Apple – we have Hon Hai in the portfolio, which increased its share of the new iPhone that is coming out. We also have exposure to the autonomous and semi-autonomous car sector, which needs a supply of sensors, camera modules, software and lightweight structural components, as well battery-driven cars, which need cooling systems. We are excited about the potential of this exposure in the portfolio. We also remain very confident about our investment in the Brilliance China subsidiary of BMW. They continue to do well. It is a very orderly company with good transparency and decent management, with whom we are having a very constructive discussion about getting a board member onto the board representing all minority shareholders. Another portfolio sector that went up was consumer discretionary, mainly representing the automobile sector.

As we have talked about some of our largest holdings I won't go through the top-ten holdings in detail. One of the outliers though is Unilever – we have faced criticism in the past over the stock, as it is not considered an emerging market company. We have always argued that it is though with over 60% of their business being in emerging markets. If you look at the forecast that is communicated by the company itself that number will go all the way up to 80% and the recent noise around the Heinz Kraft/Buffet takeover attempt is leading to a lot of internal reform. They are cleaning up their portfolio and debottlenecking some of their operations, which has driven up the share price to even higher highs. So, we have actually been benefitting from that investment.

TEMIT Top 10 Holdings
as at 31 May 2017

Issuer	Sector	Country	% of Total
Brilliance China Automotive	Consumer Discretionary	Hong Kong / China	7.3
Samsung Electronics	Information Technology	South Korea	7.0
Naspers, N	Consumer Discretionary	South Africa	4.8
Taiwan Semiconductor Manufacturing	Information Technology	Taiwan	4.5
Unilever	Consumer Staples	United Kingdom	3.9
Tencent	Information Technology	Hong Kong / China	3.8
Hon Hai Precision Industry	Information Technology	Taiwan	2.9
Buenaventura, ADR	Materials	Peru	2.9
Alibaba, ADR	Information Technology	Hong Kong / China	2.9
Astra International	Consumer Discretionary	Indonesia	2.9
Total			42.9

The Ten Largest Holdings represent the ten largest holdings of TEMIT as at the date indicated. These securities do not represent all of the securities purchased, sold or recommended for clients, and the reader should not assume that investment in the securities listed was or will be profitable. All portfolio holdings are subject to change. Holdings of the same issuer have been combined.

In closing, I'd like to highlight our efforts to look for opportunities in the frontier market space. Pakistan, as you know, used to be a frontier market is now an emerging market and it remains a substantial part of the portfolio. Peru is also a substantial part of the portfolio. We have made our first investment in Kenya in the last six months, investing in three companies that are already having a positive contribution to performance. Vietnam is a place we would love to get more exposure to, but considering the market there is at a nine and a half year high is making us a little bit hesitant.

In outlook, I expect that it is probably going to be a fairly challenging year with regards to the risks I talked about earlier, but we believe that the portfolio is well positioned to protect us from that.

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