FRANKLIN TEMPLETON INVESTMENTS

Investment Team Update

30 November 2018

Bulls Return to Emerging Markets in November

EMERGING MARKETS INSIGHTS

Three Things We're Thinking About Today

1. During the G20 meeting, U.S. President Donald Trump and Chinese President Xi Jinping reached a 90-day **trade truce** to allow both countries to negotiate a comprehensive trade agreement. The US will postpone increasing tariffs to 25% from 10% on US$200 billion worth of Chinese products, while China agreed to substantially increase purchases of American goods and negotiate on structural changes with the US. If no conclusion is reached, the US will raise tariffs to 25%. While the agreement was welcomed by markets and signaled both leaders' desire to avoid a full-blown trade war, we believe that uncertainties remain as both countries look to reach an agreeable compromise. 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.

2. The Indonesian rupiah and stock market were among the top emerging-market (EM) performers in November, as government and central bank efforts to stabilize the currency bore fruit, and the country continued to report solid economic growth rates. An increase in interest rates and a decline in oil prices also eased pressure on the currency and widening current account deficit. Overall, **Indonesia** has demonstrated continued resilience to external shocks, benefitting from ongoing reforms over the last decade that have sought to balance its growth drivers and accelerate domestic development. We continue to find potential investment opportunities in many sectors that benefit from existing demographics and expected reforms. These include banks, which lend to both fast-growing corporates and provide mortgages, credit cards and other retail banking products to consumers, as well as companies in the consumer, resources and infrastructure-related sectors.

3. We are excited about the prospects for the EM **pharmaceutical industry**, particularly smaller companies. The sector looks promising to us due to three primary drivers: demographics, environmental and lifestyle changes, and innovation. The rapid pace of innovation is perhaps the most surprising driver we see for growth in these types of companies. In recent years, many leading developed-market (DM) pharmaceutical companies have struck partnerships with EM pharmaceutical companies. As increasing prosperity drives demand for health care and healthier lifestyles, EMs are becoming sources of significant growth for the pharmaceutical industry and a center for innovation within the industry itself. We believe this area offers exciting potential for investors, one that will be a significant driver of advancement in society in both EMs and DMs alike in the decades ahead. We are of the opinion that EM health care and pharmaceutical companies are just entering the early stages of development..

Market Performance (MSCI EM Index, USD)
Cumulative Return

Best	Worst
+Turkey (13.1%)	-Pakistan (-5.4%)
+Indonesia (12.3%)	-United Arab Emirates (-5.3%)
+India (-0.4%)	-Mexico (-4.8%)

Sector Performance (MSCI EM Index, USD)
Cumulative Return

Best	Worst
+Real Estate (9.7%)	-Energy (-1.0%)
+Industrials (5.9%)	-Materials (-0.2%)
+Consumer Discretionary (5.4%)	-Telecommunication Services (2.9%)

Currency Performance (vs. USD)
% Change

Best	Worst
+Turkey (6.7%)	-Brazil (-4.1%)
+South Africa (6.5%)	-Pakistan (-3.2%)
+Indonesia (6.3%)	-Russia (-1.8%)

Source: FactSet, one-month period ending 30/11/18.

Outlook

Investor sentiment towards EMs improved recently as dovish comments from US Federal Reserve Chairman Jerome Powell raised expectations of an interest rate hike pause in 2019 and led to a more bearish view on the US dollar. An announcement of a trade truce between the US and China post month-end could further support sentiment in the immediate term. However, over the longer term, uncertainties remain as both countries work towards reaching a more permanent solution.

We believe EM valuations have become more attractive as a result of low investor confidence earlier in the year, while cash flows improve and dividend payouts continue. Although EM earnings growth lagged developed markets in 2018, we expect EM earnings growth to resume momentum in 2019, as fundamentals remain strong and many EM currencies have adjusted significantly in 2018.

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 30 November 2018.

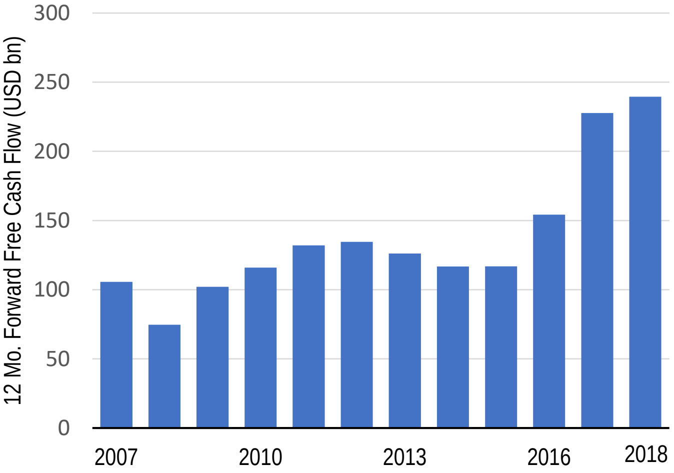
While short-term volatility may continue, as value-oriented and long-term investors, we continue to seek companies that demonstrate sustainable earnings power and trade at a discount relative to their intrinsic value and other investments available in the market.

Emerging Markets Key Trends and Developments

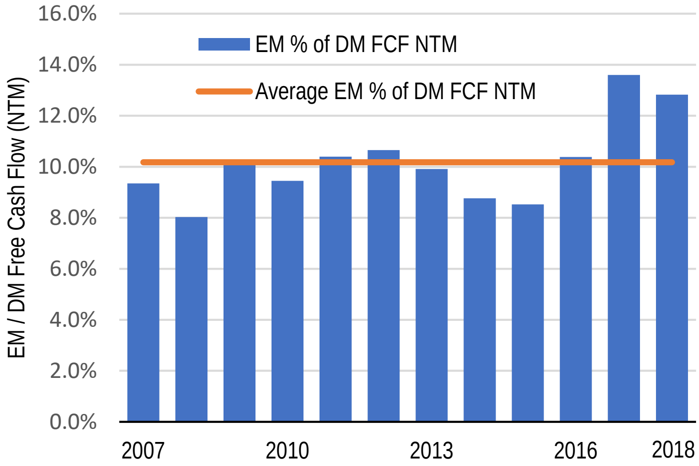
EM equities rebounded in November and outpaced DM stocks. Hopes for a slower pace of US interest rate hikes in 2019 lifted global markets and buoyed EM currencies against the US dollar. Tentative signs of a respite in US-China trade tensions also supported emerging markets. The MSCI Emerging Markets Index returned 4.1% over the month, compared with a 1.2% increase in the MSCI World Index, both in US dollars.

Emerging Markets Improving Free Cash Flows

Rising EM Free Cash Flow Levels
2007 – 2018E



Improving EM FCFs Compared to DM FCFs
2007 – 2018E



Source: Factset. Factset Emerging Markets Estimates are represented by the MSCI Emerging Markets Index. MSCI makes no warranties and shall have no liability with respect to any MSCI data reproduced herein. Indexes are unmanaged and one cannot invest directly in an index. Index returns do not reflect any 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 equities rose, with local currency strength boosting returns in US-dollar terms. Indonesia, India and China drove the advance. Indonesia's stock market rallied, aided by an upswing in the Indonesian rupiah after the central bank unexpectedly raised interest rates to reduce a current account deficit. Stocks in India rose on the back of a stronger Indian rupee, as lower oil prices eased concerns about the oil-importing nation's trade deficit. Investor sentiment toward China improved, as an upcoming meeting between US and Chinese leaders set the stage for potential progress in trade talks. In contrast, Pakistan, Malaysia and Taiwan led declines. Pakistan's market fell amid a sharp drop in the Pakistani rupee, while the country sought a bailout from the IMF. Malaysia's economy grew less than expected in the third quarter, hindered by weaker exports.

- Latin American markets, led by Mexico and Peru, corrected in November. Brazil and Colombia also ended the month with declines. Increased political and economic policy uncertainty coupled concerns that persistent inflation could result in higher interest rates weighed on the Mexican market. Equity prices in Brazil corrected on profit-taking, following a double-digit return in October. Gross domestic product (GDP) growth in Brazil accelerated to its highest growth rate this year in the third quarter but failed to meet market expectations. Chile, however, bucked the downward trend, with a positive return driven by appreciation in the Chilean peso, a strengthening economy and progress on its pension reform initiative.

- Emerging European markets generally gained, with strong performances recorded in Turkey, Hungary and Poland. The Turkish market rebounded in November with a double-digit return, following significant weakness earlier in the year. Appreciation in the Turkish lira further boosted returns in US-dollar terms. Sentiment in Hungary and Poland benefited from better-than-expected third-quarter GDP growth and an increase in the OECD’s (Organization for Economic Co-operation and Development) 2018 and 2019 growth rate projections. Easing liquidity concerns in Poland’s banking sector further supported equity prices in that market. Lower oil prices and increased geopolitical risk weighed on share prices in Russia. Elsewhere, appreciation in the South African rand was largely responsible for the solid US-dollar market performance in South Africa.

- Frontier markets, as a group, recorded positive returns, outperforming their DM counterparts but underperforming EMs. Estonia, Argentina and Sri Lanka were among the top-performing markets. The Baltics states of Lithuania, Latvia and Estonia appealed to index provider MSCI to assess them as a single region and not as individual markets for the purposes of index classification. Investors in Sri Lanka remained positive despite continuing political instability. In Argentina, the IMF completed its second review, paving the way for a US$ 7.6 billion disbursement. At the other end of the spectrum, Jordan, Tunisia and Nigeria ended the month with declines.

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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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


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