WHAT FRANKLIN TEMPLETON THINKS…

Q2 2019

…About TRADE & TARIFFS

Trade Conflicts Are One Symptom of Difficult Political Dynamics

- We expect a deceleration in trade and a moderation in global growth as the global economy shifts toward US-led growth.
- US-China trade policy negotiations still pose risks for the global economy.
- Uncertainties over trade policy outcomes and timelines ***have*** had material impacts.
- If you add all the stated tariffs that could potentially be imposed and carry that through to GDP, it's not trivial, but it is manageable.
- However, trade conflict reflects the frustrations of populations rejecting globalization and turning inward.
- It is symptomatic of the political dynamics in the US and other countries that may also lead to fiscal deficits, unorthodox economic policies and, in some places, authoritarian control.

…About US EQUITIES

Best House in a Decent Neighborhood: Positive US Fundamentals

- US market growth, margins and returns are above global peers.
- Despite strong YTD returns, valuations are still reasonable, given the low interest rate/inflation environment. We expect earnings growth to moderate this year to the mid- to high single digit range.
- We are in the later stages of the economic cycle—valuations no longer seem cheap, but they appear reasonable relative to historical averages.
- We are focused on companies and industries with strong secular tailwinds with the ability to grow earnings in most economic environments.
- Higher-quality companies also should be better positioned to navigate future uncertainty.
- Technology is permeating almost every industry. Disruptive companies are forcing companies in all industries to spend on technology in order to stay relevant.

…About BREXIT, UK and EU

A Long Extension to Uncertainty?

- The Article 50 deadline extension to October 31 could mean that any exit plan developed will need a final public vote to approve the plan or remain.
- Most don't want a "no deal" Brexit, but it could still happen by accident, due to competing interest groups and entrenched views.
- UK corporate profits remain high and the economy has shown promising signs, including a strong labor market and an improved fiscal position.
- Equity market uncertainty is high due to the challenging political backdrop; UK bonds are likely to remain sought after in the interim.
- In the EU, negative sentiment has arisen out of declining global trade growth and domestic activity. With the ECB not close to raising rates, banks are acting as a drag.
- The sheer unpopularity of European equities piques our contrarian interest.

…About EMERGING MARKETS

Strong EM Prospects Raise Our Conviction in Bonds and Stocks

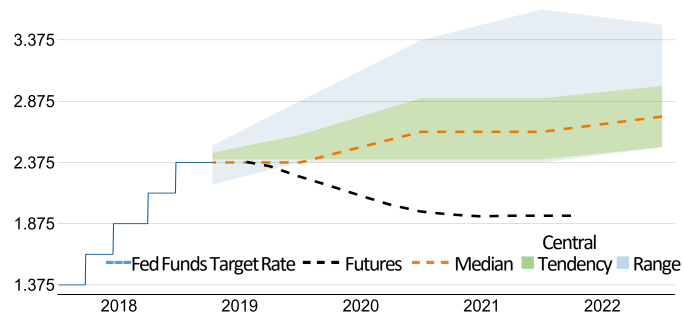
- A softer US dollar appeared to remove a headwind for EM last year as recovering EM currencies prompted investors to redeploy assets there.
- A subset of countries with stronger fundamentals and/or relatively higher yields should be in position to absorb external rate pressures.
- Select local-currency markets show some of the highest levels of undervaluation across global fixed income markets; selectivity is key.

…About INTEREST RATES & INFLATION

US Rate Risk Remains Significantly Underappreciated by Markets

- We believe the Treasury rally and curve inversion after the FOMC's dovish shift in March was overdone.
- We expect yields to rise on ongoing resilience in the US economy, ongoing strength in labor markets and rising wages.
- The FOMC's decision to keep interest rates steady came as little surprise, but it's updated "dot plot" projections were seen as decidedly more dovish than expected.

Fed Dot Plot vs. Futures Curve[1]



- We don't see conditions prompting a need for rate cuts in the next year; in fact, we see greater likelihood of conditions prompting hikes than cuts.
- Globally, the European Central Bank and Bank of Japan appear in no position to pull back on monetary accommodation, and the Bank of England remains constrained by the uncertainty over Brexit.

…About FIXED INCOME

Shorter Durations May Be Warranted

- The Fed's dovish turn should have more of an impact on the front end of the yield curve than the long end.
- We expect longer-term US Treasury yields to rise, driven by fundamental and technical pressures.
- We favor exposure to short duration and Treasury bills near term.
- Despite the support of a strong economy, valuations in high yield have eroded so that we now have a neutral stance; bank loans may be an attractive alternative, but loss of covenants are a concern.
- In the Eurozone, valuations appear full in core markets, though some peripheral markets remain attractive.

Franklin Templeton Investments comprises multiple independent investment teams located around the world. As individual portfolio managers and teams pursue different fund mandates, there will always be different views held on the markets, and we consider that a strength. The insights above represent the current views of senior investment leaders and are subject to change.

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Key Themes

THEME	RATIONALE
Innovation Is Relentless	In all parts of the economy and every industry, innovation is changing the way companies do business. IBM's CEO Ginni Rometty recently stated that she expects artificial intelligence to change 100% of jobs in the coming years.[2] In a disruptive environment like this, there will be winners and losers, so we believe having an active hand navigating the shifting seas for opportunities, and investment flotsam, will be vital.
Consider Lower Volatility Profiles for Core Equity	Fundamentals continue to be positive, with no signs a recession is due this year. Nonetheless, the higher volatility experience of the last six months appears likely to persist. Investors seeking participation in the equity markets with more muted volatility or greater downside protection may want to consider choices that have historically shown they offer such benefits.
Complacency—the Forerunner of Mediocrity—Should Be Avoided in Income	Markets quickly became complacent with the Fed's more dovish stance in March, not only pricing out any further rates hikes in 2019, but also pricing in a rate cut for next year. We believe there is a great misperception of the risk to rising rates, given growing fiscal deficits, rising inflationary pressures and strong US growth. Investments with low or negative correlations to rising US rates and more idiosyncratic opportunities may prove to be desirable.
A Case Developing for Non-US Equities	Global conditions have stabilized in many areas, which when coupled with emerging markets fundamentals, warrant consideration. Key risks are expected to ease, or are already reflected in valuations, and earnings growth is expected to improve from 2019 onwards, compared to a normalization of US earnings.

1. Source: Macrobond,, CME Group, Federal Reserve. Dot plot as of March 2019 meeting. OIS futures curve as of 4/8/2019. OIS (overnight index swap)/market consensus. Participants' projections of the appropriate level of the target federal funds rate (rounded to the nearest 1/8 percentage point) at the end of the specified calendar year. Projections are summarized in the form of a median, weighted average, central tendency, and range. The central tendency is the range of participant projections, excluding the three highest and three lowest projections for each year. **For illustrative purposes only.**
2. Source: CNBC, April 3, 2019.

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