WHAT FRANKLIN TEMPLETON THINKS...

Q4 2019

...About RECESSION

Are We Talking Ourselves into a Recession?

- Slowing global growth is a rising concern.
- Risks are rising, but probability of recession remains only moderate.
- The deeper the trade slowdown and the longer it persists, the harder it is to see the global economy escaping contagion.
- If uncertainty rises to a degree where corporations really start to pull back on capital expenditures, that could be a self-fulfilling mechanism.
- While earnings growth is slowing, near term that is not likely to translate into an economic recession.
- On the positive side, both the US and Europe show high levels of employment and positive consumer confidence.

...About GLOBAL EQUITIES

Cautious but Not Bearish

- Global equities are still supported by corporate earnings, but profit margins appear to have peaked.
- Concerns remain about growth and capital investment plans.
- The potential for renewed market volatility warrants caution.
- In Europe ex-UK, economic activity has slowed due to global trade concerns and weaker manufacturing activity.
- Markets have discounted much of the negative sentiment, and the earnings yield is much higher than the yield on government bonds.[1]

...About US EQUITIES

Remain Nimble and Selective

- Trade uncertainty has put a lid on the outlook for equities.
- Corporate profits remain high, even if profit growth is diminishing.
- Buybacks have been propelling the markets.
- Despite ongoing trade tensions, US growth remains stronger than in other developed markets, although earnings have dipped.
- Market likely to focus on valuations, margin pressure, and the Fed.
- Emphasis should be on bottom-up security selection.

...About BREXIT

October 31: Fright Night?

- October is the crunch month for Brexit.
- The UK government insists the UK will leave the European Union at the end of the month. However, the Benn Act, a law enacted in September, requires the PM to ask for an extension if the House of Commons does not approve a withdrawal agreement or no deal by October 19.
- The truth is nobody knows.
- Markets appear to be getting more stretched. We anticipate increased volatility as the impact from a policy error or geopolitical shocks could be higher.
- Resilience in key parts of the underlying economy and historically cheap valuations are positives for the long-term outlook for UK equities, though we are neutral in the near term.

...About EMERGING MARKETS

Balance of Growth Concerns and Optimism

- Slower growth environment highlights emerging markets' idiosyncratic risks and underlying cyclicality.
- Valuations remain attractive relative to developed market peers.
- Improved corporate governance across EM is seen as a structural driver for EM equity re-rating.
- China's equity market has rebounded on stimulus measures and the economy has stabilized.
- Brazil is a secular improvement story and South Korea is showing resilience, while volatility has remained high for Argentina and Turkey.

...About INTEREST RATES

Question the Normalization of Negative Interest Rates

- Central banks around the globe are doubling down on unconventional policy, with little history to draw from. Negative rates can be counterproductive.
- The Fed has made two Q3 cuts to the US Fed funds rate but indicated there is little reason to expect significant further easing, as expectations are for growth to remain solid, the labor market to remain strong and inflation to gradually move up to target.

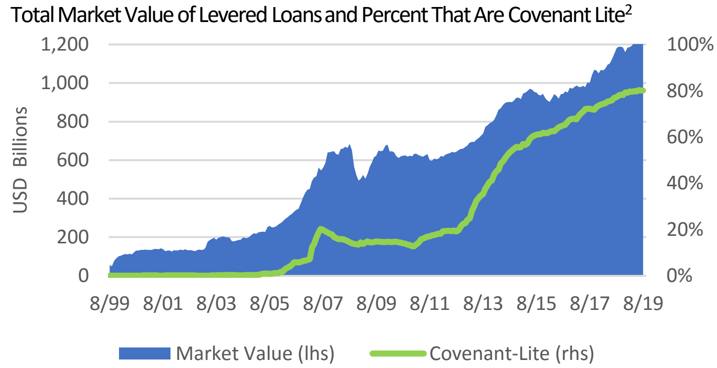
...About FIXED INCOME

A Balance Between Reasons for Optimism and Valuation Concerns

- At the broadest asset allocation level, we remain neutral on bonds.
- Government bonds are distorted by the major role played by central banks, which are essentially inviting investors to bet on lower rates.
- US investment grade bonds remain supported by strong corporate fundamentals. Some widening of yield spreads seems likely as growth slows and financial conditions tighten. Yields remain attractive, relatively.

Taking Risk Too *Litely*?

Total Market Value of Levered Loans and Percent That Are Covenant Lite[2]



- The US business cycle is entering its later stages, so we have a more cautious stance on the outlook for lower-rated sectors. Default rates appear to be rising to historical averages, and bank loans are potentially vulnerable due to the relaxation of covenants.
- Be selective in emerging markets.

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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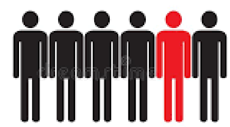
Key Themes

THEME	RATIONALE	
Seek Innovation and Generational Companies	AI (artificial intelligence), blockchain, autonomous vehicles, IoT (internet of things)—all are examples of potentially transformative technologies that may produce tomorrow's Apple, Google or Facebook. Innovative companies and those supplying them help drive equity markets, over the long term. Biotech is entering the most transformative phase our health care analysts have seen in 25 years. New treatment paradigms, including gene and cellular therapies, have jumped from lab to marketplace to tackle difficult diseases.	
Time to Rein in Risk? Think Dividends, Quality, Value and Flexibility	A more cautious stance in equities may be worth considering, as US consumer strength is offsetting weakness elsewhere. The reemergence of volatility appears unlikely to change. Staying invested in the equity markets using funds with a history of more muted volatility, greater downside protection potential or tactical flexibility can be a route to consider. High-quality companies and those paying dividends may differentiate themselves during market uncertainty. Value's long relative exile appeared to shift in September and may signal a factor rotation is underway.	
Consider the Benefits of Municipal Bond Funds	Supported by a technical tailwind from a stable muni supply and strong demand trends, municipal bonds offer investors diversification advantages that could prove beneficial during periods of late-cycle market volatility. In an asset class with low correlation to equity returns, active management supported by robust credit research may help sort valuable from vulnerable ahead of any market downturn. And, of course, there are the federal and potential state tax-free income benefits.[3]	
Dare to Be Different than Average	Global conditions warrant selectivity rather than broad asset class exposure. Actively-managed funds that offer non-index-like exposure and have distinct, deliberate approaches and opportunity sets may prove their worth in the months ahead and beyond. It is always worth considering that what has worked best over the last 10 years is unlikely to be what works best over the next 10 years.	

1. Source: Macrobond., MSCI, Bloomberg., 8/31/19. Earnings yield derived from MSCI EAFE Index; government bond yield as represented by Bloomberg Barclays Global Aggregate Government Index.
2. Source: Credit Suisse, 8/31/19. Important data provider notices and terms available at www.franklintempletondatasources.com.
3. For municipal bond fund investors subject to the alternative minimum tax, a small portion of fund dividends may be taxable. Distributions of capital gains are generally taxable.

All investments involve risks, including the possible loss of principal. 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. Non-diversified funds that concentrate in the biotechnology sector involve risks such as patent considerations, product liability, government regulatory requirements, and regulatory approval for new drugs and medical products. Smaller, mid-sized and relatively new or unseasoned companies can be particularly sensitive to changing economic conditions, and their prospects for growth are less certain than those of larger, more established companies. Investments in fast-growing industries like the technology sector could result in increased price fluctuation. Bond prices generally move in the opposite direction of interest rates. As the prices of bonds in a fund adjust to a rise in interest rates, the fund's share price may decline.

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Franklin Templeton Distributors, Inc.
One Franklin Parkway
San Mateo, CA 94403-1906
(800) DIAL BEN® /342-5236
franklintempleton.com