WHAT FRANKLIN TEMPLETON THINKS...

...About TRADE & TARIFFS

Alphabet soup helps settle stomachs as NAFTA to become USMCA.

- There is a risk these things can spiral, but positive steps—for example, in recent trade negotiations between Mexico, the United States, and Canada—show there is a way through trade disputes by updating treaties instead of just tearing them up.
- The irony is that most of the terms that are in the United States, Mexico, Canada Agreement (USMCA), the replacement for the North American Free Trade Agreement (NAFTA), were basically from the Trans-Pacific Partnership (TPP).
- The escalating trade rhetoric between the US and China is arguably the biggest "known unknown" that concerns central banks, economists and investors alike.
- If these tariffs take hold, consumer spending could take a hit and more companies may put planned investments on hold.
- Bottom line: The issue will probably increase market volatility but we don't think it will impact fundamentals all that much.

...About US EQUITIES

The US economy continues chugging along but beware of equity volatility speed bumps.

- Despite elevated geopolitical headlines and trade tensions, US growth fundamentals continue to be positive.
- Tax reform is providing a tailwind for earnings, and valuations appear to be at reasonable risk/reward levels against a backdrop of low unemployment and moderate inflation.
- While the market is offering attractive opportunities, they are less abundant than in recent years.
- Investors need to be more selective in their risk exposures, as broad market beta is more expensive than it has been.

...About EUROPE, JAPAN and UK EQUITIES

The US is driving the global growth train, but less robust international growth and political concerns are offset by better valuations.

- In Europe, we believe growth has peaked, though equity valuations have appeared reasonable relative to potential reward.
- Recent British pound weakness has helped boost short-term performance in UK equities. But Brexit looms as an event that could destabilize the EU and UK. We expect UK economic headwinds.
- Japan's growth outlook is mediocre. Leading indicators are weakening, although we don't expect a major downturn given strong labor markets and the global growth outlook. Valuations on a price-to-book value basis are still attractive vs. other markets.

...About EMERGING MARKETS EQUITIES

Not all emerging markets are turkeys.

- First, EM comprises diverse countries with different economic growth drivers and political risk that do not move in lockstep.
- With some exceptions—e.g. Turkey—the asset class as a whole remains in good health.
- Asia appears to be relatively stable, while Latin America is more of a turnaround story where policies are now getting, or trying to get, better. There are likely more alpha opportunities in Latin America.

...About INTEREST RATES & INFLATION

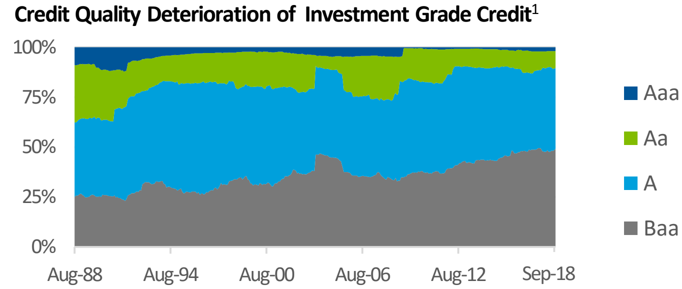
All things in good measure.

- Central banks around the world generally appear to be taking things in a cool, measured stride.
- We don't expect to see any ECB rate hikes until 2020.
- In contrast, the Bank of England (BoE) raised rates in August, and signaled more rate hikes to come if inflation looks to accelerate.
- The US Federal Reserve (Fed) has signaled that inflation appears to be manageable. With the US economy running hotter, the Fed appears poised for one more rate hike this year and three next year.

...About FIXED INCOME

The "Investment Grade" (IG) seal of approval might be tarnished.

Credit Quality Deterioration of Investment Grade Credit[1]



- Not all BBB (Baa) debt is the same. It now makes up almost half the Bloomberg Barclays US Corp Index, double that in the '90s.[1]
- High-yield bonds are enjoying positive tailwinds, given shrinking supply.
- The bank loan market now rivals high-yield in terms of size. With investor demand outstripping bank loan supply, we are seeing more investors relinquishing control over credit terms. Greater vigilance to distinguish loans without adequate lender protections is required.
- Rising rates leave duration assets vulnerable.
- Selective positioning is important in emerging markets, as some countries are more exposed to the rising cost of capital.

1. Source: Bloomberg Barclays U.S. Corporate Index, 9/30/18.

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.

Key Themes

THEME	RATIONALE
Growth Appears to Still Be in the Driver's Seat, but Anticipate Potential Potholes	Technology is driving secular shifts across many sectors—including finance, retail, healthcare and energy—which are having profound impacts on many industries. Among all disruptive changes, however, there are good and bad investments. We believe innovation is the main driving force behind value creation in the global economy, but determining the temporal intersection of the visionary and the valuable is often best navigated by active managers.
Climb the Wall of Worry	Investor skepticism is typically a positive sign of a healthy market. While some fear the ongoing removal of monetary stimulus (letting Fed-owned Treasuries and mortgage-backed securities run off without reinvestment), US economic fundamentals in the near- and intermediate-term appear to support continued growth. The loss of monetary stimulus has been replaced by fiscal stimulus, in the form of lower personal and corporate tax rates, and deregulation. Early signs of the benefits include rising capital expenditures, which seems likely to sustain itself in coming quarters.
Use Active Bond Management in a Rising Rate World	Sudden spikes in the 10-year Treasury yield can be disruptive to funds not managing duration risk. From the end of August through October 5th, it jumped 38 bps or 13%.[2] As the credit cycle ages, credit risk will become more important, in a landscape that has dramatically changed over the last decade. Almost 50% of the investment grade universe is now rated BBB (Baa). Better research is required to discern bonds likely to deteriorate if economic conditions falter. As the size of the bank loan market has exploded vis-a-vis high yield bonds, more effort is required to understand the new dynamics of each and their interplay. Select emerging market debt appears attractive, but some EM markets are disasters.
Consider the Alternatives	Alternative investments, including real assets and TIPs may see stronger numbers late in the economic cycle. Hedged strategies are potentially aided by higher interest rates (and the effects on cash rich vs. heavily- indebted companies), rising dispersion between winners and losers, and overall increased volatility.

2. Source: Federal Reserve H.15 Report. 10/6/18.

All investments involve risks, including the possible loss of principal. Stocks historically have outperformed other asset classes over the long term, but tend to fluctuate more dramatically over the short term. Investments in fast-growing industries like the technology and healthcare sectors (which have historically been volatile) could result in increased price fluctuation, especially over the short term, due to the rapid pace of product change and development and changes in government regulation of companies emphasizing scientific or technological advancement or regulatory approval for new drugs and medical instruments. 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. Floating-rate bank loans and high yield bonds carry a greater degree of credit risk relative to investment-grade securities. 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. Hedge strategies may employ currency management strategies or short sales, derivatives and merger arbitrage that may result in increased risk.

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