January 2020

WHAT FRANKLIN TEMPLETON THINKS...

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

...About THE CANADIAN ECONOMY

- Canadian economic data took a turn to the downside over the 4th quarter, with real GDP year-over-year falling from 2.1% as of August 2018 to 1.2% more recently. If excluding the consumer, residential real estate and government spending, growth would be negative.
- Inflation in Canada remains a "show me" story despite a slight drift higher in headline inflation metrics over the quarter. Core inflation is close to 2%; right in the middle of the Bank of Canada's 1%-3% target.
- Canada has currently the highest policy rate of all developed markets. When combined with a strong Loonie, the high rate gives the Bank of Canada more tools to support the Canadian economy and consumer.

...About CANADIAN FIXED INCOME

- The U.S. and Canadian yield curves steepened over the quarter, with only the Canadian curve remaining inverted. The Canadian yield curve steepened, but only moved to flat overall and remains inverted out to 30 year and flat from overnight to 30 year given both have yields of 1.75%.
- While Canadian bond yields could drift slightly higher over the near term, we expect them to remain largely range bound as Canadian macro fundamentals don't support significantly higher interest rates.
- We continue to favour corporate bonds as fundamentals remain fair but have preference for higher quality credits. We expect credit spreads to remain range-bound but acknowledge risks are growing to the downside.
- With general weakness in U.S. Dollar (USD) vs. CAD over the quarter, we have increased the net USD allocation in our fixed income strategies that allow for foreign currency exposures.

...About CANADIAN EQUITIES

- Canadian equities have continued to demonstrate strong performance with 2019 being the strongest year since 2009. Despite strong general advances, the varied returns across sectors sends some mixed messages where investor confidence and caution conflict.
- The S&P/TSX Composite Total Return Index experienced increased volatility in 2019, especially in the second half of the year. During this period market factors rotated from outperformance of momentum stocks to a general outperformance of quality and fundamental factors.
- While low interest rates in isolation increase the attractiveness of equities, they have simultaneously contributed to an abundance of capital chasing a limited investment opportunity set.
- Trade and geopolitical tensions remain elevated with implications for go-forward global growth dynamics. As much as risks and uncertainties cloud the near term, we can be certain that the future will bring threats and opportunities. We remain ready to take advantage of these dislocations as they present themselves.

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...About U.S. FIXED INCOME

- We expect the Fed to keep rates on hold through at least the first half of 2020.
- The Fed's extremely loose stance has contributed to asset valuations that appear stretched across most sectors. Essentially, the Fed has simply traded volatility today for an unknown quantity of volatility at an uncertain point in the future.
- The investment-grade sector remains supported by strong corporate fundamentals; however, leverage is high, and technical conditions may prove challenging. Some widening of yield spreads is likely as growth slows and financial conditions tighten.
- The business cycle is entering its later stages, leading us to adopt a more cautious stance on the outlook for lower-rated fixed income sectors such as high yield.
- Selective opportunities exist in Asset-Backed Securities and in agency Mortgage-Backed Securities.

...About U.S. EQUITIES

- In the U.S., despite ongoing trade tensions, growth remains stronger than in other developed markets.
- Attention will likely focus on valuations, pressure on margins and whether Fed rate cuts meet expectations and boost growth.
- We think the U.S. economy can continue to grow in a range of 2%-3% a year for much longer than many believe. We base this view on two main factors: consumer strength and corporate earnings. As always, we emphasize the importance of bottom-up security selection.

...About EUROPEAN EQUITIES AND BREXIT

- With the assistance of supportive monetary policy, economic growth is likely to continue, making global equities an appealing asset class in 2020. We believe that it makes sense to seek out selective long-term opportunities in innovative companies and value stocks with clear catalysts.
- Global equities are still supported by corporate earnings, but profits margins have peaked. Concerns remain regarding growth momentum and capital investment plans.
- We are carefully monitoring the potential for renewed market volatility and have moved to reflect these concerns in a more cautious stance.
- In Europe ex-U.K., economic activity has slowed as global trade concerns and weaker manufacturing activity have dampened sentiment.
- We believe the market has already discounted these conditions, so we are cautious rather than bearish. On the positive side, domestic demand has been resilient. And, as always, we recognize the value of bottom-up security selection.
- Following the December elections, we believe some of the short-term political uncertainty in the United Kingdom has eased.
- Going into 2020, we maintain a constructive view on U.K. equities. In addition to the improved sentiment, we believe there is a notable amount of pent up corporate investment that we expect to come through next year given the much-improved political backdrop.
- Moreover, wage growth in the U.K. remains above the inflation level, providing good disposable income for the U.K. consumer, underpinning consumption and supportive for earnings in our view.
- The U.K. domestic agenda in 2020 will be driven by the Brexit negotiations with the European Union (EU) and the scope of the budget, which we believe will likely be presented in the first quarter. It's clear to us that the scale of the Conservative majority will help in the negotiation process with the EU, but the possibility of this merely allowing further brinksmanship is a concern. On the fiscal side, the electorate will expect promises for greater spending on housing and infrastructure to be honoured.

…About GLOBAL GROWTH AND EQUITY VOLATILITY, RECESSION?

- We recognize the world faces uncertainty. But we focus on hard data, and we see few signs the global economy is headed toward recession.
- The world's largest economy, the U.S., remains on steady footing. This despite persistent trade uncertainty and a contentious political environment.
- Of course, risk factors remain, like weaker manufacturing activity, declining business sentiment, trade tensions, and rising political polarization.
- Because of these risks, we see opportunity in 2020. Investors should be selective and ready to take advantage of potential market shocks as well as focus on true portfolio diversification.

…About EMERGING MARKET (EM) EQUITIES AND FIXED INCOME

- Being selective by country and security is particularly important.
- EM growth is forecasted by the International Monetary Fund to accelerate in 2020 and remain more than double that of developed markets. Improving fiscal, economic and monetary policies and a renewed focus on structural reforms in many emerging markets has been gaining traction.
- China will be a frontrunner in the 5G arena together with Artificial Intelligence (AI) and robotics. This will help drive growth in China's new economy as it strives to become less reliant on the U.S.
- Taiwan is seeing some spillover benefits from the trade war as its companies start onshoring some operations. Government incentives to attract operations back to Taiwan will have ripple effects on the domestic economy.
- In terms of EM debt, events in developed markets will be key in terms of volatility in 2020. U.S. Treasuries are likely to gyrate ahead of the U.S. presidential election, and financial markets have shown their sensitivity to U.S.-China trade talks. A slowdown in some of Europe's traditional growth engines, such as German manufacturing, may have knock-on effects for European emerging markets.
- Broadly speaking, a focus should be on avoiding developed market volatility in 2020, while capitalizing on the higher yields and diverse opportunities offered by the EM universe.

…About FOREIGN TRADE & TARIFFS

- The slowdown in global trade, the dominant economic theme of the past year, may be showing signs of stabilization.
- As evidenced by the signing of Phase One of the U.S.-China trade deal, it seems investors are willing to look favourably on signs of easing in the strained trade negotiations between these global super powers.
- While we see progress, ultimately the dispute is still unresolved. As such, we remain skeptical as to its near-term impact on growth. A comprehensive agreement is needed. Stay tuned.

…About ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG)

- Companies must think differently in order to adapt and sustain their business models, with a focus on forward-looking data.
- For example, global population growth and urbanization are driving increased demand for energy, food and water. Estimates suggest global energy usage and food production will grow 50% by 2030, with water usage up 30% over the same time period.
- This expected increased demand presents complex challenges to companies competing globally for finite materials. In response, we're seeing a growing focus on the efficient use of resources. This includes rethinking investment opportunities in areas like waste management.

Key Themes New Year's Resolutions

THEME	RATIONALE
New Year's Resolution: Work the Core (North America)	Canadian economic data took a downturn in the 4th quarter of 2019 with the fall in real GDP, yet on the other hand, low interest rates in isolation continued to increase the attractiveness of Canadian equities. Despite the overall strong performance results in 2019, the performance across different sectors continues to send mixed messages. Trade and geopolitical tensions will remain elevated with implications for go-forward global dynamics and it will be important to remain ready to take advantage of the opportunities while wary of the threats that arise. The U.S. equity market appears unlikely to deliver the same results as in 2019, but it still may be one of the top games in town. Given the somewhat higher than historical valuations of the indexes, prudence may warrant finding approaches that seek to avoid lower quality companies and reduce volatility.
New Year's Resolution: Improve Flexibility	Nimble management of portfolios may be required if volatility picks up this year. Funds offering flexible mandates may be able to capitalize on the opportunities that volatility presents.
New Year's Resolution: Lose (Excess Risk) Weight	Lower volatility strategies in fixed income may help investors in managing overall portfolio fluctuations without going to cash. Active management supported by robust credit research in an asset class that sports a low correlation to equity returns may help sort "valuable" from "vulnerable" ahead of any market downturn.
New Year's Resolution: Travel More	While international equity markets may not appear as favourable overall, their valuations reflect lower expectations. A focused exploration of select opportunities could prove rewarding. Emerging markets may offer greater potential, especially over the long-term, while short-term volatility throughout developed markets could have a knock-on effect. In fixed income, select global markets and currencies offer better potential value than many traditional bond sources.
New Year's Resolution: Get Active	Active management may be worth considering in select areas of portfolios as the economic expansion continues into its 11th year. For example, equity funds with high active share scores may help ensure that portfolios don't mimic index-driven results.

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