Franklin K2 Multi-Strategy Alternatives Fund

Series F
June 30, 2021

Fund Commentary

Performance Review

- Global equity markets overall advanced during the second quarter of 2021. Progress in vaccination campaigns and businesses reopening, along with ongoing monetary and fiscal stimulus, aided continued economic recovery in several parts of the world. Inflation was the dominant market theme during the quarter as supply chain disruptions and higher commodity prices combined with low base effects to drive up inflation around the globe. Fixed income markets broadly advanced as US Treasury yields fell and spreads tightened. The Refinitiv/CoreCommodity CRB Index of 19 key commodities reached a six-year high with a sharp quarterly gain.
- For the quarter, the fund's Series F shares returned 2.81%, and its benchmark, the HFRX Global Hedge Fund Index, returned 2.41%.

QUARTERLY KEY PERFORMANCE DRIVERS

	Strategy	Manager	Sectors / Currencies / Index Hedges
HELPED	Long Short Equity	Portland Hill (Long/Short Equity)	Health Care (Long)
	Event Driven	Chilton (Long/Short Equity)	Information Technology (Long)
	Relative Value	Jennison (Long/Short Equity)	Consumer Discretionary (Long)
HURT	—	One River (Relative Value)	Equity Index Hedges
	—	Graham (Global Macro)	Currency Hedges
	—	RV Capital (Global Macro)	Volatility Indexes (Long)

- On a gross basis, all four strategies contributed to the portfolio's performance in the second quarter, with the bulk of contribution from the long short equity strategy. Overall, long equity positioning drove the majority of absolute contribution, led by the health care, information technology (IT) and consumer discretionary sectors. Credit was a substantial contributor, as long positions in corporate bonds across multiple sectors contributed, led by health care, communication services, consumer discretionary and IT. Conversely, currency positioning was a modest detractor as the US dollar showed weakness for much of the quarter before strengthening in June. Equity index hedges also partially offset the portfolio's gains.
- The long short equity strategy was the largest contributor to returns. Long equity positioning in health care, IT, consumer discretionary and industrials drove contribution, with additional gains across a wide variety of sectors. Subadvisors Portland Hill, Chilton, Jennison and Wellington Tech were the portfolio's top four performers for the period. Consumer discretionary holdings were a key driver for Portland Hill and Chilton, with additional strength in health care. Jennison's leading contributors spanned biotechnology, health care equipment and services, and life sciences. The strategy gains were partially offset by equity index hedges, especially the S&P 500® Index, which closed the quarter at a record high.
- The event driven strategy was also a substantial contributor, driven by long equity positions in industrials, IT and utilities. Subadvisors PSAM and Bardin Hill were both significant contributors, each helped by long positions in a US-based rare disease therapy company whose acquisition by a global pharmaceuticals firm was approved by US regulators.
- Long exposure to high-yield corporate bonds was a key driver of contribution from the relative value strategy, with strength in the health care, communication services and IT sectors. Gains were spread across multiple subadvisors, led by Loomis. Subadvisor One River was a modest detractor, largely due to volatility index positioning, though the subadvisor has outperformed volatility benchmarks since its March inception.
- Long positions in developed market stock indices drove contribution from the global macro strategy. Long positions in emerging market (EM) bond assets were also key contributors. Currency trading detracted from performance, including EM currency hedges and US dollar longs against some developed market currencies.
- During the quarter, the team increased exposure to global macro subadvisor BlueBay and relative value subadvisor Lazard, and reduced exposure to global macro subadvisor Emso. The Conditional Risk Overlay (CRO) was not implemented.

Outlook & Strategy

- With society and economies in transition, investors must underwrite to a wide range of potential outcomes. Progress on vaccinations, central banks beginning a cycle of tightening policy, and earnings growth are important variables that are difficult to gauge. Given the uncertainty embedded in the underlying core markets, we believe it is prudent to focus hedge fund investments on alpha generating non-directional strategies.
- Given peak valuations across many traditional risk assets, relative value strategies appear particularly attractive due to their less directional nature and ability to benefit from pricing inefficiencies that exist at intersection points of multiple markets. We have a favourable outlook for convertible and volatility arbitrage given continued strong issuance and inefficient pricing. The outlook for fixed income arbitrage is more muted due to central banks' success in depressing global rate volatility.
- We are bullish on opportunities in the global macro strategy. Managers focused on macro factors may benefit from a rich opportunity set as data releases and policy paths continue to play a critical role across markets. Macro developments continue to drive global markets with managers focused on these factors facing a potentially rich opportunity set over the medium term. Recent data releases have contributed to shifting market narratives around future policy paths, which may favour nimble and opportunistic trading styles.

- We believe that active, long-duration, fundamental long/short equity managers will be challenged in the near term by the market's volatile rotations. Though stocks have rallied extensively this year, there have been more frequent short-term swings as investors grapple with record high valuations and unclear monetary policy. These various uncertainties should continue to negatively impact active, long-term fundamental managers, particularly those focused on secular growth.
- Turning to the event driven strategy, we hold a neutral position. We expect continued active supply of corporate events due to ample liquidity, peak valuations, and continued management team incentives to grow market share and earnings. We remain mindful of potential risks to the strategy should liquidity conditions deteriorate.

Fund Details

Inception Date	08/02/2016
Benchmark Name	HFRX Global Hedge Fund Index, ICE BofA US 3-Month Treasury Bill Index

Fund Description

Capital appreciation with lower volatility relative to the broad equity markets by tracking the performance (net of fees) of FTIF Franklin K2 Alternative Strategies Fund (the "Underlying Fund"), which invests in a wide range of nontraditional or alternative strategies.

Performance Data

Performance (%) as of 06/30/2021

	1 Mth	3 Mths	YTD	1 Yr	3 Yrs	Since Inception	Inception Date
Series F	1.00	2.81	2.62	11.42	3.06	3.15	10/03/2016
HFRX Global Hedge Fund Index	0.38	2.41	3.73	12.01	4.22	3.97	-
ICE BofA US 3-Month Treasury Bill Index	0.00	0.00	0.02	0.09	1.34	1.22	-

Indicated rates of return include changes in unit or share value and reinvestment of all distributions and dividends and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. Please refer to the prospectus for further details. **For details on the respective series inception dates, please consult the Fund Facts or simplified prospectus for the fund.** Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. **Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.**

Investment Team

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Years with Firm 15
Years Experience 37

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Series F is available to investors participating in programs that do not require Franklin Templeton to incur distribution costs in the form of trailing commissions to dealers. As a consequence, the management fee on Series F is lower than on Series A.

Indexes are unmanaged, and one cannot invest directly in an index. They do not reflect any fees, expenses or sales charges.

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