FRANKLIN TEMPLETON | Institute

June 2023

Global Investment Outlook

Mid-year 2023 outlook: Time to engage more fully

Introduction

Stephen Dover, CFA
Chief Market Strategist
Franklin Templeton Institute

For this mid-year outlook, the theme continues to be the attractiveness of investments beyond cash including fixed income, equities and alternatives. We give you our Institute perspective for the second half of 2023, with our ongoing conversations with our investment teams driving the narrative. The major highlights are:

- Fixed income deserves a good deal of attention—delivering income is back.
- Diversification and income may be enough motivation to move some holdings further out the US yield curve.
- Equities should benefit from a taming of inflation and earnings optimism.
- Following consecutive quarters of falling US corporate profits, the outlook for earnings is beginning to brighten.
- A US recession remains the overwhelming consensus view and hence is to some extent already accounted for in market prices—it is likely to come later and be shallower than its predecessors.
- Our risk worry list includes deep recession, geopolitical tensions, energy shocks and soggy returns.

In this issue, we follow our outlook with some useful exhibits from our investment teams as they provide primary points they are making when discussing opportunities for the rest of the year.

Hint of stability

If 2022 was a year when nothing went right for investors, then the first half of 2023 flipped the script. Despite a series of mishaps over the past six months—ranging from falling corporate profits, to some of the largest bank failures in US history, to an overwhelming consensus predicting recession—stocks and bonds each staged strong rebounds in the first half of this year. After a miserable 2022, the classic 60%–40% mix of US stocks and bonds etched a 6% gain in the first six months of 2023.[1]

Does that portend a weak second half? Will the familiar adage, "sell in May and go away" prove prescient for the final two quarters of 2023? We don't think so, and we don't subscribe to selling in May—or June or July for that matter. Nor do we think returns will be soggy; that is a risk, but not our base case.

Rather, we believe the second half of 2023 offers opportunities for investors to get cash off the sidelines. There will be challenges, and a vertical bull market is hardly our view. But the opportunities on offer—near and longer term—point to a simple conclusion. It is time to engage more fully.

More than climbing a wall of worry

The rebound in global equity and fixed income markets in the first half of 2023 took place despite aggressive Federal Reserve (Fed) tightening, consecutive quarters of falling corporate profits, the second- and third-largest bank failures in US history, the US federal government's near-default, and amid universal predictions of US and global recessions.

How did the equity market rebound happen, given that backdrop? It was more than just "climbing a wall of worry." This year, stocks and bonds enjoyed a reprieve from rising energy prices and wage inflation declined from its peak. Geopolitical tensions, while high, did not repeat much less escalate their shocks from 2022. The Fed and other federal and foreign government entities stepped in to rapidly and effectively contain banking crises. Compromise and, yes, even bipartisanship, averted a US government default. All those factors helped risk premiums subside, which in turn boosted the prices of many stocks and bonds.

The growing fascination with artificial intelligence (AI) applications also buoyed US equity markets. The share prices of a subset of AI darlings, albeit some of the largest companies in the S&P 500 Index, roared ahead, lifting overall market averages. Indeed, the divergence between the 2023 fortunes of the few, and the more lackluster performance of the rest, reached historic proportions for the S&P 500 in the first half of 2023.[2]

We believe the second half of 2023 offers opportunities for investors to get cash off the sidelines. There will be challenges, and a vertical bull market is hardly our view. But the opportunities on offer—near and longer term—point to a simple conclusion. It is time to engage more fully.

Narrow leadership portends better things

Various observers have noted that the narrow leadership of global equity markets in recent months is unsustainable and warn of trouble ahead.

We see things differently. Following consecutive quarters of falling US corporate profits, the outlook for earnings is beginning to brighten. Globally, earnings revisions are turning upward, above all in Europe (especially in Germany). By early 2024, which is well within the forward-looking timeframe of markets, we expect US corporate profits growth to accelerate to a double-digit clip.[3]

True, company analysts are congenitally over-optimistic, but several points are worth underscoring:

- First, the low point in global earnings is more likely with us, rather than ahead of us. China's corporate profits, which fell in the fourth quarter of 2022, are beginning to turn higher, as are those in Europe.
- Second, the earnings recession that typically accompanies an economic recession has already preceded it. That means that investors have already factored in much negative profit news into today's share prices.

- Third, this economic cycle is unlike its predecessors in one very important aspect. Specifically, the collapse of labor supply that occurred because of the pandemic (and has not gone away since then) has resulted in a persistent excess demand for labor. Simply put, job growth is much stronger than might be expected at this stage of the cycle. That, in turn, has both delayed and reduced the likelihood of a recession, given the beneficial impact of rising household incomes on consumer spending, which accounts for over two-thirds of total US final demand.

The bottom line is that if a US recession occurs—which remains the overwhelming consensus view and hence is to some extent already accounted for in market prices—we believe it is likely to come later and be shallower than its predecessors. Nor is it inconceivable to imagine that the ongoing profits recession may end before an economic recession arrives—if it ever does.

Yes, there are risks

No outlook is complete without a candid appraisal of the risks. Stuff could happen. Some outcomes, however, can be at least partly diversified. Others, of course, could prove more challenging.

- Deep recession: Persistent inflation and concerted global central-bank tightening accompanied by fiscal restraint (as the debt ceiling compromise is implemented via spending cuts) could tip the US and global economies into recession, perhaps sooner and deeper than we anticipate. However, if investors have extended duration holdings (as we favor), gains on US Treasuries should at least partially offset probable losses in global equities and emerging local currency debt markets.
- An escalation of geopolitical tensions: Among the scenarios that could manifest is a disorderly retreat of Russian forces in the face of a successful Ukrainian counteroffensive. That outcome could provoke Russian President Vladimir Putin into a dangerous escalation of force—potentially including tactical nuclear weapons. Markets would shudder at the repercussions, even if duration fixed income might offer some refuge. Other hotspots, such as Taiwan and the South China Sea, have the potential to become flash points and sources of market risk.
- A global disruption to energy supplies: A sharp rise in energy costs could trigger more than just concerns about global growth. It could also renew anxiety about inflation and possible monetary policy responses. And for balanced portfolios, unexpected inflation is a non-diversifiable risk, as investors painfully learned in 2022.
- Soggy returns: If, against our expectations, profits growth remains anemic, global growth slows, and inflation remains stubbornly above central bank target levels, then it's possible that neither stocks nor bonds (nor emerging debt markets) will muster much in the way of returns. Volatility would probably remain elevated, making risk-adjusted returns even less desirable. That is a possibility over the next six months. But is unlikely to be a lasting phenomenon. This risk, put differently, could be the price for being early, rather than for being wrong.

Engage in opportunity

The implication is that narrow leadership is likely to give way to more breadth, creating more opportunity for astute investors. The fading drag of negative profits, a peak in US and global policy rates (as inflation recedes over the remainder of 2023), and probable US dollar weakness (the Fed paused its prolonged rate-hike cycle in June), are likely to produce more, not fewer, opportunities over the next six months in equity, fixed income and currency markets.

The bottom line is that if a US recession occurs—which remains the overwhelming consensus view and hence is to some extent already accounted for in market prices—we believe it is likely to come later and be shallower than its predecessors. Nor is it inconceivable to imagine that the ongoing profits recession may end before an economic recession arrives—if it ever does.

Here is where we see the greatest potential investment opportunities:

- **Time to engage more fully**—Many investors have understandably parked cash in money market funds yielding over 5%; we believe it is also opportune to move some holdings further out the US yield curve. The prospect of peak policy rates, further declines in US inflation and some slowing of growth are apt to push long-term yields lower over the second half of the year, boosting returns on safe, longer-duration fixed income holdings. As we point out below, taking duration risk also typically improves portfolio diversification.

- **Investment-grade credit**—The highest-quality areas of the credit market have become more attractive, providing higher yields in investment-grade bonds relative to the dividends from equities.

- **Generally high-quality, short duration**—When broadly looking at higher-quality credit, the default risk premiums are sufficiently attractive to compensate investors, even with some probable slowing of economic activity. Accordingly, within credit markets, we broadly prefer higher-quality, shorter-duration holdings.

- **Selected long-duration bonds**—The case for higher-quality, long-duration bonds has improved as a likely peak in interest rates arrives sooner rather than later. A decline in rates could provide more capital appreciation to the more interest-rate sensitive longer-duration Treasuries, as well as selected corporate bonds trading at discounts to par.

- **High-quality high yield**—However, high-yield bonds with stronger ratings profiles due to better fundamentals look to be a potential total return opportunity. Particularly when compared to equities, high-yield debt has a shorter duration profile than other parts of the fixed income market, while at the same time providing equity-like total return potential.

- **Emerging market debt**—Another opportunity, which we also noted at the beginning of this year, exists in emerging market local currency debt. Attractive yields (double-digit in some cases) coupled with US dollar weakness, offer an opportunity to enjoy equity-like returns, but without the degree of downgrade or default risk we see in US high-yield credit markets.

- **US equities**—Looking beneath the surface, bifurcated earnings streams may be creating new patterns of return dispersion. Share prices are responding to earnings outcomes in different ways across sectors and styles. The disparity in returns may increase as earnings variability could be a key factor behind finding "winners and losers."

- **Non-US equities**—Just as we noted at the end of last year, we believe it's prudent to consider opening or establishing larger positions in non-US markets. We understand the reluctance. After a decade of massive US equity outperformance (since 2013, cumulative 20% versus Japan's Nikkei, over 70% versus the German DAX, and nearly 150% versus the UK FTSE),[4] US investors are rightfully skeptical of taking their portfolios overseas. But over the past six months, the Nikkei has doubled the S&P 500's 7% return, and the German DAX has trumped it by three full percentage points. It is happening because of more attractive valuations and because of superior earnings upgrades, which we expect will continue.

- **Historic opportunity in private credit**—With rates still elevated relative to recent history, private credit will likely pick up a larger share of the loan market from regional banks. Given these dynamics, private credit managers will have the ability to more easily negotiate favorable pricing, terms and covenants.

With this hint of stability, second-half opportunities arrive in almost too many places, including alternatives.

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Exhibits for mid-year opportunities

We gave our investment teams the challenge to provide the exhibit that best suggests opportunities in the second half of 2023. It is important to understand the specialty perspective to appreciate the points made. We hope you find this both interesting and useful.

Multi-asset income perspective

Contributed by:

Ed Perks, CFA

Chief Investment Officer

Franklin Income Investors

Bond Yields Have Risen Substantially from Pandemic Lows ...

Exhibit 1: Corporate Credit: Average Yield-to-Worst (YTW)

December 31, 2020–May 31, 2023

Sources: Bloomberg, Bloomberg Indexes. For illustrative purposes only. US Investment-Grade Corporates YTW is represented by the Bloomberg US Corporate Bond Index, US High-Yield Corporates YTW is represented by Bloomberg US Corporate High Yield Bond Index. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results**. Important data provider notices and terms available at www.franklintempletondatasources.com.

- Yield is set to remain an important component of total return for investors during the next six months, given our expectation that the Fed will pause its rate-hiking cycle, rather than pivot to easier monetary policy.
- US corporate bond yields have risen as a consequence of higher interest rates, with average yields on investment-grade (IG) issues remaining above 5% and above 8% for US high-yield issues. This makes for an attractive opportunity for income investors, in our view.
- IG credit is our preferred asset class in terms of total return, income and risk management. We believe these assets offer a better total return setup than equities, while the positive correlation with stocks is also breaking down, allowing fixed income to offset equity market volatility.
- The increased probability of a shallow US recession should limit the negative impact on corporate earnings moving into the second half of 2023. As a result, we believe the high-yield bond sector is more resilient than many investors think.
- We don't think spreads are likely to blow out, which means we are very comfortable being in the credit space, at historically elevated yields. For us, it is a relatively straightforward call to add selectively to high-yield credit at the expense of higher volatility equity holdings which, in a recessionary scenario, should underperform credit.

Fixed income perspective

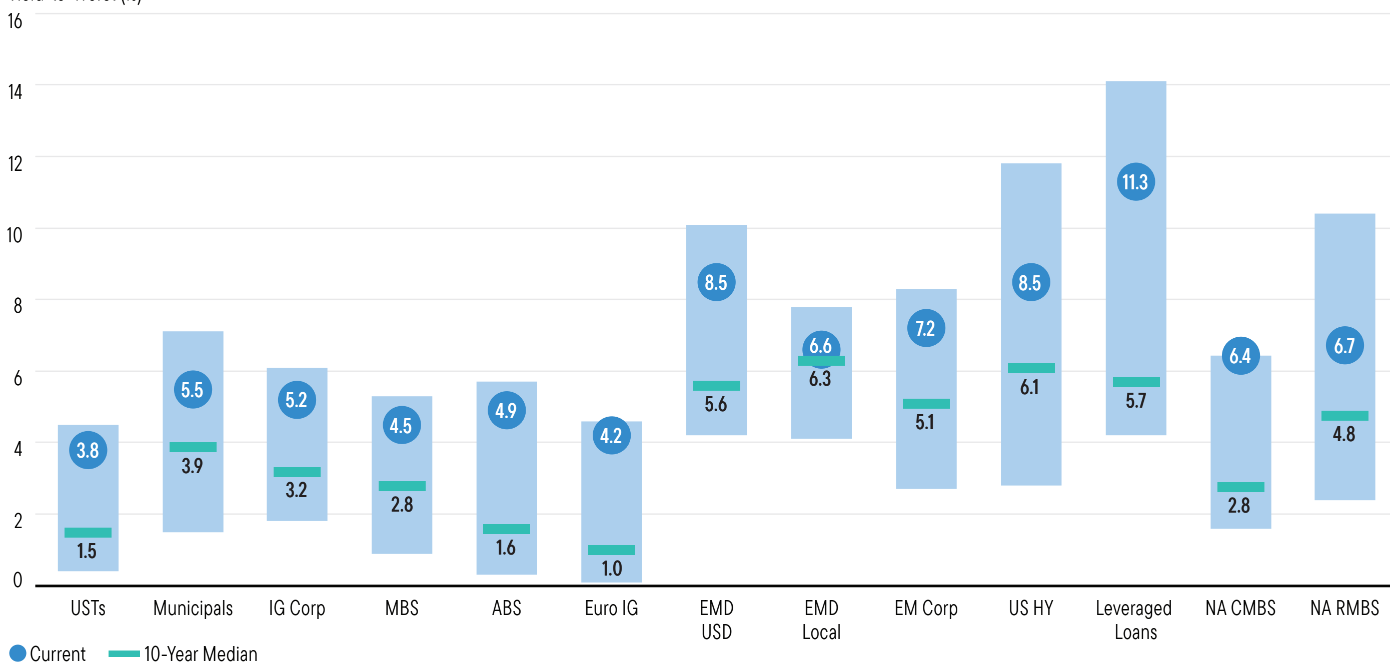
Contributed by:

Western Asset

Bond Yields and Valuations Have Been Restored

Exhibit 2: Yield-to-Worst Across Fixed Income Sectors (Past 10 Years)

As of March 31, 2023



Sources: Bloomberg, FactSet, J.P. Morgan Credit Research, J.P. Morgan Asset Management. US Treasuries (USTs) are represented by the Bloomberg US Treasury Index; municipals are represented by the Bloomberg Municipal Bond Index; investment-grade (IG) corporate is represented by the Bloomberg US Corporate Index; mortgage-backed securities (MBS) are represented by the Bloomberg US MBS Index; asset-backed securities (ABS) are represented by the Bloomberg ABS Index; Euro IG is represented by the Bloomberg Euro Aggregate Corporate Index; emerging market debt (EMD) USD is represented by the JP Morgan EMIGLOBAL Diversified Index; EMD Local is represented by the JP Morgan GBI-EM Global Diversified Index; EM Corporate is represented by the JP Morgan Corporate Emerging Markets Bond Broad Diversified Index (CEMBI Broad Diversified); US high yield (HY) is represented by the Bloomberg US Corporate High Yield Index; leveraged loans are represented by the JP Morgan Leveraged Loan Index; non-agency (NA) commercial mortgage-backed securities (CMBS) are represented by the NA component of the Bloomberg CMBS IG Index; NA residential mortgage-backed securities (RMBS) are represented by the JPMorgan NA RMBS Credit Index.

Yield-to-worst is the lowest possible yield that can be received on a bond apart from the company defaulting. All sectors shown are yield-to-worst except for municipals, which is based on the tax-equivalent yield-to-worst assuming a top-income tax bracket rate of 37% plus a Medicare tax rate of 3.8%.

Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results**. Important data provider notices and terms available at www.franklintempletondatasources.com.

- One benefit following the recent rough patch is that bond yields and valuations have been restored, so investors are now much more likely to find opportunities for enhanced yield.
- More attractive valuations amid falling inflation sets the table for a more promising investment environment.
- With valuations in better shape, inflation slowing and volatility down, we think the case for fixed income today is very strong.

Fixed income perspective

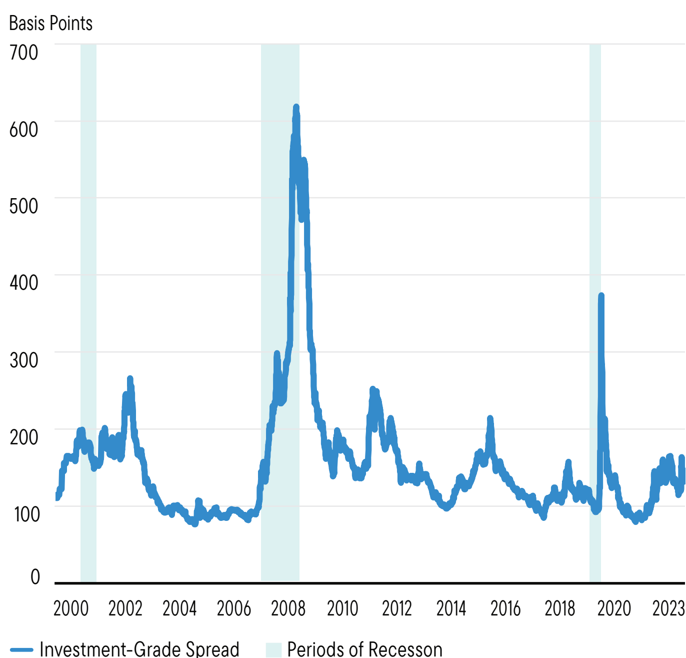
Contributed by:

Franklin Templeton Fixed Income

Guarding the Bottom Line: The Significance of Security Selection for Corporate Credits

Exhibit 3: Investment-Grade (IG) Spread

As of January 2023



Source: Bloomberg. The IG spread is based on the Bloomberg US Aggregate Bond Index, a broad based, market capitalization-weighted bond market index representing intermediate-term investment-grade bonds traded in the United States. Indexes are unmanaged and one cannot directly in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results**.

- As ratings downgrades continue to exceed upgrades, corporate credits have trended toward a divide between (or bifurcation of) those that have the financial standing to withstand a slowing economic backdrop versus those that are vulnerable. Corporate credit issuers that are showing signs of deteriorating fundamental positions are facing increased market headwinds, limiting their ability to access credit in the market or driving up their cost of capital. This is more pronounced in lower-rated asset classes such as floating rate bank loans and high-yield (HY) corporate bonds. Current corporate spread levels do not price in any sort of slowing economic conditions and remain well below levels seen in previous recessionary episodes. Both sector allocation and security selection are key to constructing a well-balanced portfolio, which avoids industries and companies likely to underperform as the global economy slows, while still providing attractive yield and income opportunities.
- In the HY sector, while earnings continue to be generally favorable, the impact of slowing economic growth and tightening credit conditions is starting to show up in the financial results of companies with weaker business models. Similar to the bank loan market, HY market participants are quick to dole out punishment to companies that miss earning targets, pushing credit spreads significantly wider in the market. We are encouraged that investors have begun to push back on new issuance deals with weak covenant protection. In a number of cases, investors have driven meaningfully positive changes to issuance conditions.
- In the investment-grade corporate credit space, we believe that the risk environment will likely stay challenging as the market reacts to economic data releases and shifting views about Fed policy, culminating in a potential for more volatility. Data from the current earnings season, while still ongoing, shows considerable dispersion between industries, but revenues have broadly held up, while earnings and margins declined. While yields remain generally attractive (a technical positive that helps drive demand), we still favor generally moving up in credit quality and being selective.
- In an environment of increasing margin pressures and financial performance dispersion, we believe a common thread across the corporate sector is the enduring principle of prudent security selection in navigating the macroeconomic headwinds, as well as a key driver of future returns. We continue to be selective in the credits we select for our various portfolios, while still providing additional returns.

Global equity perspective

Contributed by:

Scott Glasser

Chief Investment Officer and Portfolio Manager

ClearBridge Investments

Mega-Cap Earnings Strength Highlights Narrow Market

Exhibit 4: S&P 500: 2023 Fiscal Year Earnings Estimates

As of June 9, 2023

Source: FactSet. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

Index Performance Shows Concentrated Market

Exhibit 5: Sum of Five Largest S&P 500 Weights

As of June 9, 2023

Source: FactSet. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

- Following downward earnings revisions across the overall S&P 500 Index in the first quarter, the second quarter saw a stark reversal and separation by market capitalization. Earnings-per-share (EPS) estimates shifted higher for the five largest S&P 500 components, while a downward trend for the rest of the index was maintained.
- Strong individual company results and raised outlooks have driven upward revisions for the five largest S&P 500 components, with optimism over generative AI supporting demand.
- Market breadth has recently improved following May's US labor market data releases, which quelled some investors' fears of an imminent recession. If breadth can continue to widen and EPS revisions for more index constituents strengthen, the prospects for further gains will brighten, in our view.
- The concentration of the S&P 500 Index in its five largest components is at its most extreme levels in more than 30 years.[5]
- Although the S&P 500 Index has risen 12% so far in 2023, the five largest companies have delivered 72% of the index's price return, while the remaining 495 contributed just 28%.[6]
- This dynamic has resulted in the market-cap-weighted S&P 500 beating its equal-weighted version by 9.6%. If this gap holds through year-end, it would be the greatest divergence between the two in a calendar year since 1998.[7]
- The period following the late 1990s—which like today observed elevated market concentration and pronounced mega-cap outperformance—witnessed a reversion to the mean in valuations and performance, with previous leaders becoming laggards and vice versa. Typically, active managers are rewarded during these periods of reversion given their flexibility to avoid areas of overvaluation and overweight in areas that have been neglected.
- While it's too early to determine which path the markets will take going forward, deteriorating breadth is typically associated with a bull market on its last legs, and not a solid foundation for a rally to build upon.

Growth equity perspective

Contributed by:

Jonathan Curtis

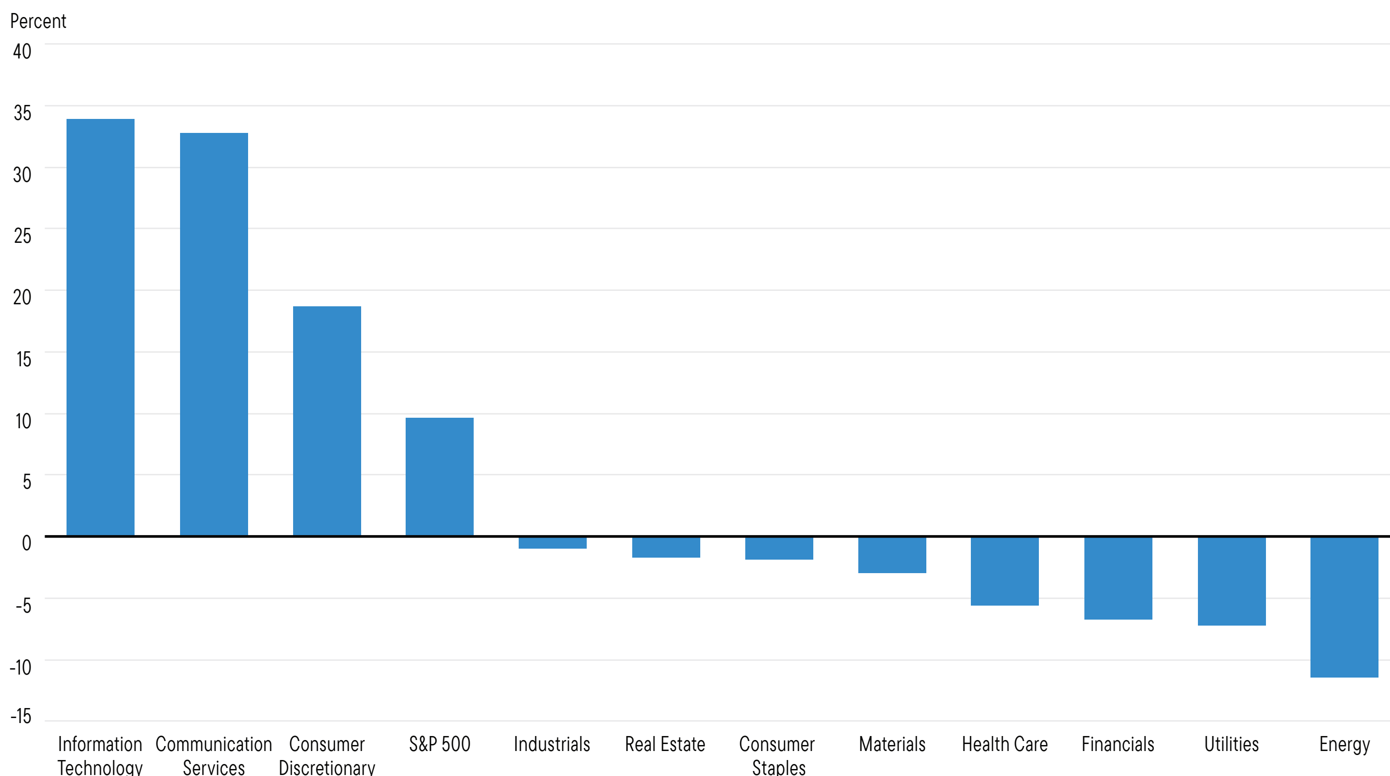
Portfolio Manager

Franklin Equity Group

US Equities: Potential for Widening Market Breadth

Exhibit 6: S&P 500 Index: Year-to-Date Sector Returns

January 1, 2023–May 31, 2023



Source: Morningstar Direct. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

- Year-to-date as of May 31, 2023, the S&P 500's positive return can be heavily attributed to seven of the world's largest companies within the information technology, communication services and consumer discretionary sectors.
- These companies have performed well, we believe, because of their many attributes, including strong balance sheets, attractive profitability, platform-like dynamics and their increased focus on efficiency in the current post-COVID, higher interest rate and uncertain macroeconomic environment.
- As we look into the second half of the year, we see the potential for widening market breadth as investors gain confidence that we are closer to the end of the rate-tightening cycle and that fundamental earnings risk may be less than feared if economic conditions show signs of stabilization.
- In our view, there are opportunities for many companies to augment their structural long-term growth potential in this era of AI and generative AI.

Global equity perspective

Contributed by:

Manraj Sekhon

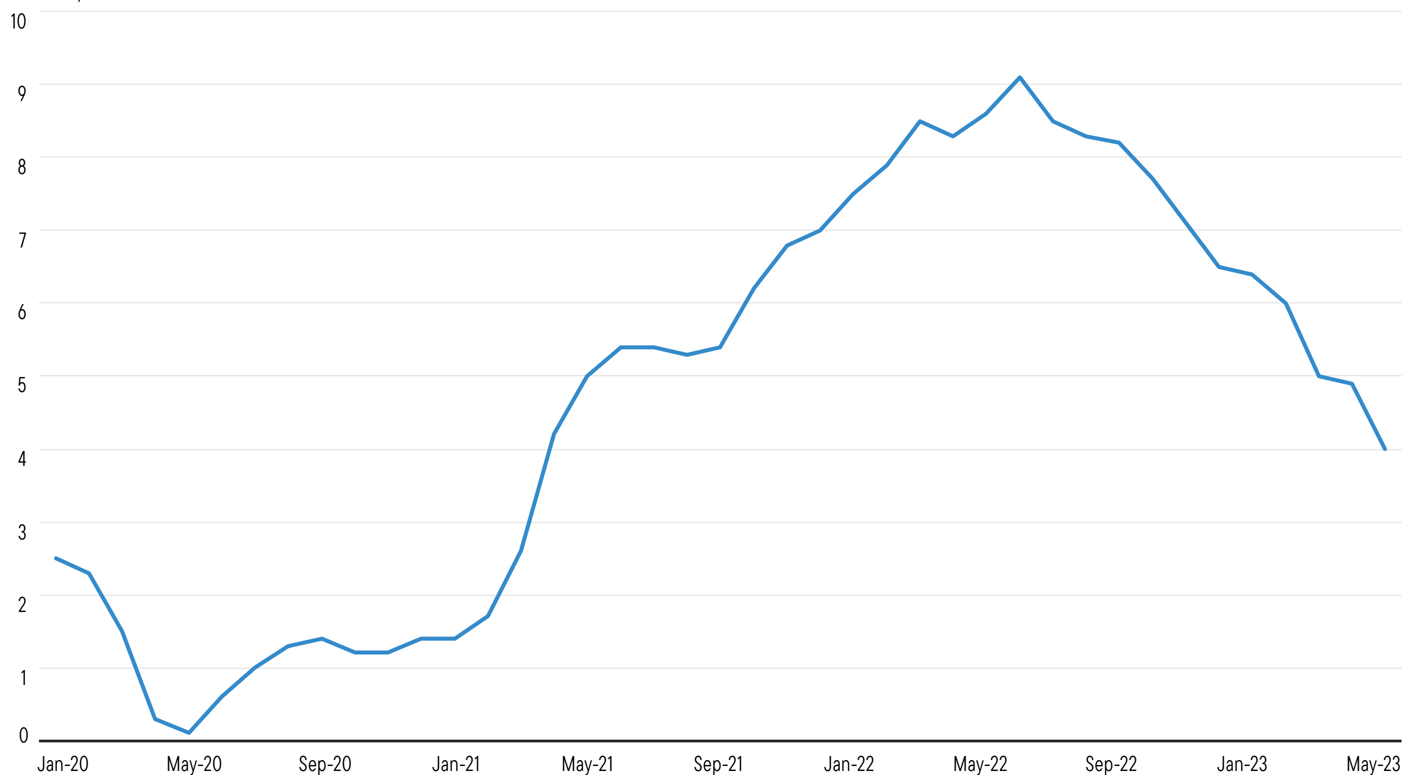
Head

Templeton Global Investments

Equity Encouragement as US Inflationary Pressures Have Clearly Weakened

Exhibit 7: US Inflation

January 1, 2020–May 31, 2023



Source: US Bureau of Labor Statistics.

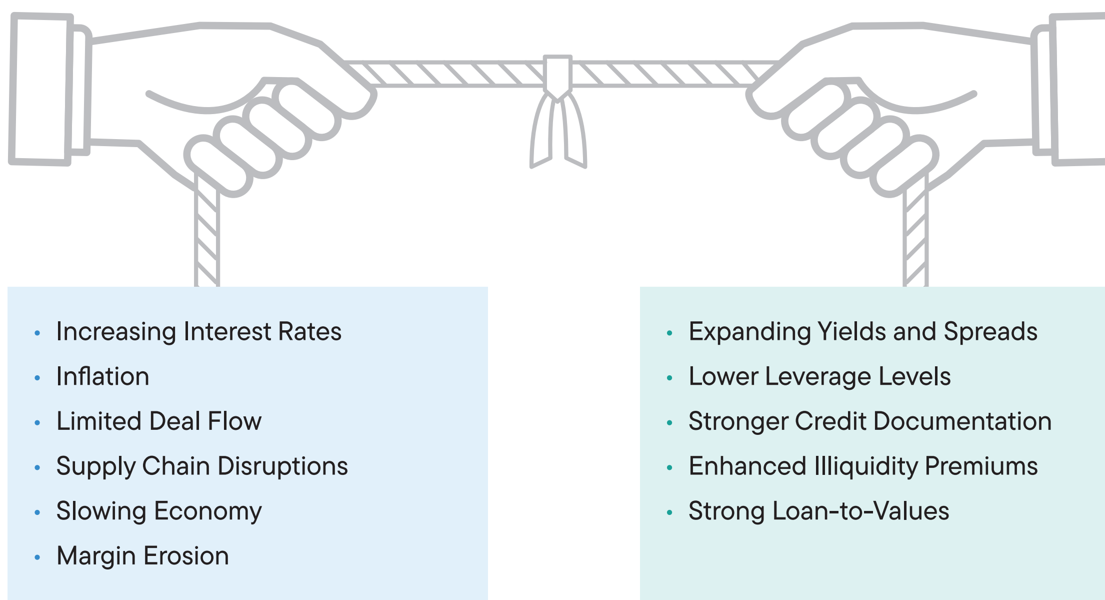
- US inflationary pressures have clearly weakened. Tighter monetary policy is leading to some slowdown in consumer spending and removing some of the froth in the labor market, as reflected in softer wage growth. This has also been helped by easing supply chain pressures post COVID-19.
- This means that the Fed is well-placed to pivot to cutting interest rates if growth slows faster than expected or in response to possible economic or systemic shocks.
- At the same time, the US economy continues to perform strongly and ahead of expectations with a robust job market and resilient consumer spending. Corporate earnings have also continued to surprise positively.
- This backdrop will keep equity markets well supported, in our view, as US recession worries diminish and investors focus on the underlying strength of the US economy, alongside a positive policy backdrop.

Private credit perspective

Contributed by:
Richard Byrne
President
Benefit Street Partners

Private Credit's Tug-of-War

Exhibit 8: Economic Headwinds vs. Private Credit Tailwindsn



- Increasing Interest Rates
- Inflation
- Limited Deal Flow
- Supply Chain Disruptions
- Slowing Economy
- Margin Erosion

- Expanding Yields and Spreads
- Lower Leverage Levels
- Stronger Credit Documentation
- Enhanced Illiquidity Premiums
- Strong Loan-to-Values

Source: For Illustrative purposes only. Views expressed are those of BSP. Such statements cannot be independently verified and are subject to change.

- Private debt has experienced dramatic growth over the past decade, with investors piling into the asset class in search of strong yields in a low-rate environment.
- The supply and demand balance has shifted negotiating power back to lenders, thanks to higher interest rates and more-limited capital in the market.
- Those with new money to lend have a great opportunity that could drive very strong risk-adjusted returns, even if the global economy slows.
- On the flip side, default rates are likely to increase as legacy issuers face the impact of higher interest rates, which could limit their ability to service debt and refinance at maturity.
- Top managers in the asset class who have constructed solid, diversified portfolios will likely outperform and take advantage of market dispersion to separate themselves from the competition when deploying new capital.
- Many of the headwinds for private debt issuers, such as rising rates and inflation and a potential slowing economy, are being offset by tailwinds such as higher credit spreads, lower leverage and stronger loan documentation.

Real estate perspective

Contributed by:

Tim Wang

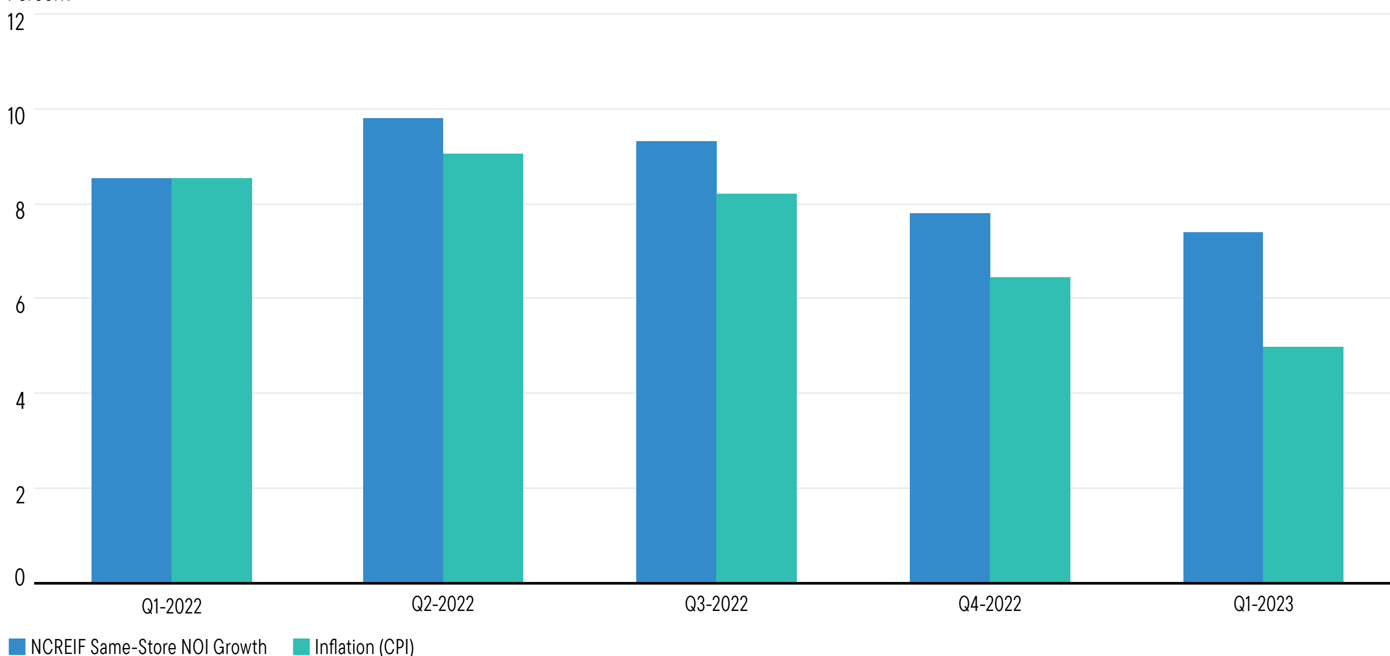
Managing Director & Head of Investment Research

Clarion Partners

Commercial Real Estate Still Offers Compelling Opportunities

Exhibit 9: Year-Over-Year Property Growth vs. Headline Inflation

2023 First Quarter



Sources: Clarion Partners Investment Research, NCREIF, US Bureau of Labor Statistics (BLS), Moody's Analytics.

Note: NCREIF is the performance benchmark for core real estate. Inflation is the non-Seasonal Adjusted Consumer Price Index for All Urban Consumers (CPI-U).

- Commercial real estate continues to offer portfolio diversification and inflation hedging benefits.
- Despite headwinds in the office sector, overall NCREIF benchmark same-store net operating income (NOI) growth has remained strong.
- This means NOI either on par with or higher than headline inflation (Consumer Price Index)—especially in the industrial, multifamily, life sciences and self-storage property sectors.

Endnotes

1. Sources: Bloomberg, S&P Dow Jones Indexes. The S&P 500 Index is used as a representative of stocks. The Bloomberg Barclays US Aggregate Index is used as representative of bonds. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results**.
2. Ibid.
3. There is no assurance any estimate, forecast or projection will be realized.
4. Source: Bloomberg. June 1, 2013, through May 31, 2023. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results**.
5. Source. FactSet. As of June 9, 2023. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results**.
6. Ibid.
7. Ibid.

About Global Investment Outlook

Global Investment Outlook allows the Franklin Templeton Institute strategists to highlight manager's views on markets across the firm. Our mission is to provide our clients with research that meets their needs and concerns. We do this by listening, understanding, and then harnessing the resources of our firm to answer the challenge. We organize around areas of exploration to develop distinct insights and their practical applications.

Two related Franklin Templeton Thinks publications of note are Allocation Views, produced by Franklin Templeton Investment Solutions, which offers you our best thinking on multi-asset portfolio construction; and, Macro Perspectives, produced by the Institute, featuring economists from across the firm dissecting key macroeconomic themes driving markets.

Contributors

Western Asset
Franklin Templeton Fixed Income

Ed Perks, CFA
Chief Investment Officer
Franklin Income Investors

Scott Glasser
Chief Investment Officer,
Portfolio Manager
ClearBridge Investments

Jonathan Curtis
Portfolio Manager
Franklin Equity Group

Manraj Sekhon
Head
Templeton Global Investments

Rich Byrne
President
Benefit Street Partners

Tim Wang
Managing Director &
Head of Investment Research
Clarion Partners

Definitions

The **Bloomberg US Treasury Index** measures US dollar (USD)-denominated, fixed-rate, nominal debt issued by the US Treasury.

The **Bloomberg Municipal Bond Index** covers the USD-denominated long-term tax-exempt bond market.

The **Bloomberg US Corporate Bond Index** measures the investment-grade, fixed-rate, taxable corporate bond market.

The **Bloomberg US Mortgage-Backed Securities (MBS) Index** tracks fixed-rate agency mortgage-backed pass-through securities guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC).

The **Bloomberg ABS Index** is the asset-backed securities (ABS) component of the Bloomberg US Aggregate index and comprises credit- and charge-card receivables, autos loan receivables and utility receivables.

The **Bloomberg Euro Aggregate Corporate Index** measures the corporate component of the Euro Aggregate Index. It includes investment-grade, euro-denominated, fixed-rate securities.

The **JP Morgan EMBI Global Diversified Index** is a uniquely weighted USD-denominated emerging markets sovereign index. It has a distinct diversification scheme, which allows a more even-weight distribution among the countries in the index.

The **JP Morgan GBI-EM Global Diversified Index** consists of regularly traded, fixed-rate, domestic currency government bonds, which international investors can readily access. It excludes countries where local market investing is subject to explicit capital controls, but eligibility consideration does not factor in regulatory/tax hurdles.

The **JP Morgan Corporate Emerging Markets Bond Broad Diversified Index (CEMBI Broad Diversified)** is a uniquely weighted version of the CEMBI. It comprises only USD-dominated emerging market bonds. The countries represented in the CEMBI Broad Diversified are the same as those in the CEMBI.

The **Bloomberg US Corporate High Yield Bond Index** measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and Standard & Poor's is Ba1/BB+/BB+ or below.

The **JP Morgan Leveraged Loan Index** is a market-weighted index that tracks the performance of institutional leveraged loans.

The Non-Agency (NA) component of the **Bloomberg Commercial Mortgage-backed Securities (CMBS) Investment Grade Index** measures the market of US Non-Agency conduit and fusion CMBS deals with a minimum current deal size of $300 million.

The **JP Morgan Non-Agency (NA) Residential Mortgage-backed Securities (RMBS) Credit Index** tracks a combination of sector- and vintage-level jumbo, CRT (credit risk transfers) and legacy RMBS, reflecting the outstanding debt in the market.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal.

Fixed income securities involve interest rate, credit, inflation and reinvestment risks, and possible loss of principal. As interest rates rise, the value of fixed income securities falls.

Floating-rate loans and debt securities are typically rated below investment grade and are subject to greater risk of default, which could result in loss of principal.

Equity securities are subject to price fluctuation and possible loss of principal.

Investing in the **natural resources sector** involves special risks, including increased susceptibility to adverse economic and regulatory developments affecting the sector.

Growth stock prices may fall dramatically if the company fails to meet projections of earnings or revenue; their prices may be more volatile than other securities, particularly over the short term.

Small- and mid-cap stocks involve greater risks and volatility than large-cap stocks.

Special risks are associated with investing in **foreign securities**, including risks associated with political and economic developments, trading practices, availability of information, limited markets and currency exchange rate fluctuations and policies; investments in emerging markets involve heightened risks related to the same factors. Sovereign debt securities are subject to various risks in addition to those relating to debt securities and foreign securities generally, including, but not limited to, the risk that a governmental entity may be unwilling or unable to pay interest and repay principal on its sovereign debt. To the extent a strategy focuses on particular countries, regions, industries, sectors or types of investment from time to time, it may be subject to greater risks of adverse developments in such areas of focus than a strategy that invests in a wider variety of countries, regions, industries, sectors or investments. China may be subject to considerable degrees of economic, political and social instability. Investments in securities of Chinese issuers involve risks that are specific to China, including certain legal, regulatory, political and economic risks.

Real estate securities involve special risks, such as declines in the value of real estate and increased susceptibility to adverse economic or regulatory developments affecting the sector.

Alternative strategies may be exposed to potentially significant fluctuations in value.

Privately held companies present certain challenges and involve incremental risks as opposed to investments in public companies, such as dealing with the lack of available information about these companies as well as their general lack of liquidity.

Digital assets are subject to risks relating to immature and rapidly developing technology, security vulnerabilities of this technology, credit risk of digital asset exchanges, regulatory uncertainty, high volatility in their value/price, unclear acceptance by users and global marketplaces, and manipulation or fraud.

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Active management does not ensure gains or protect against market declines.

Notes

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