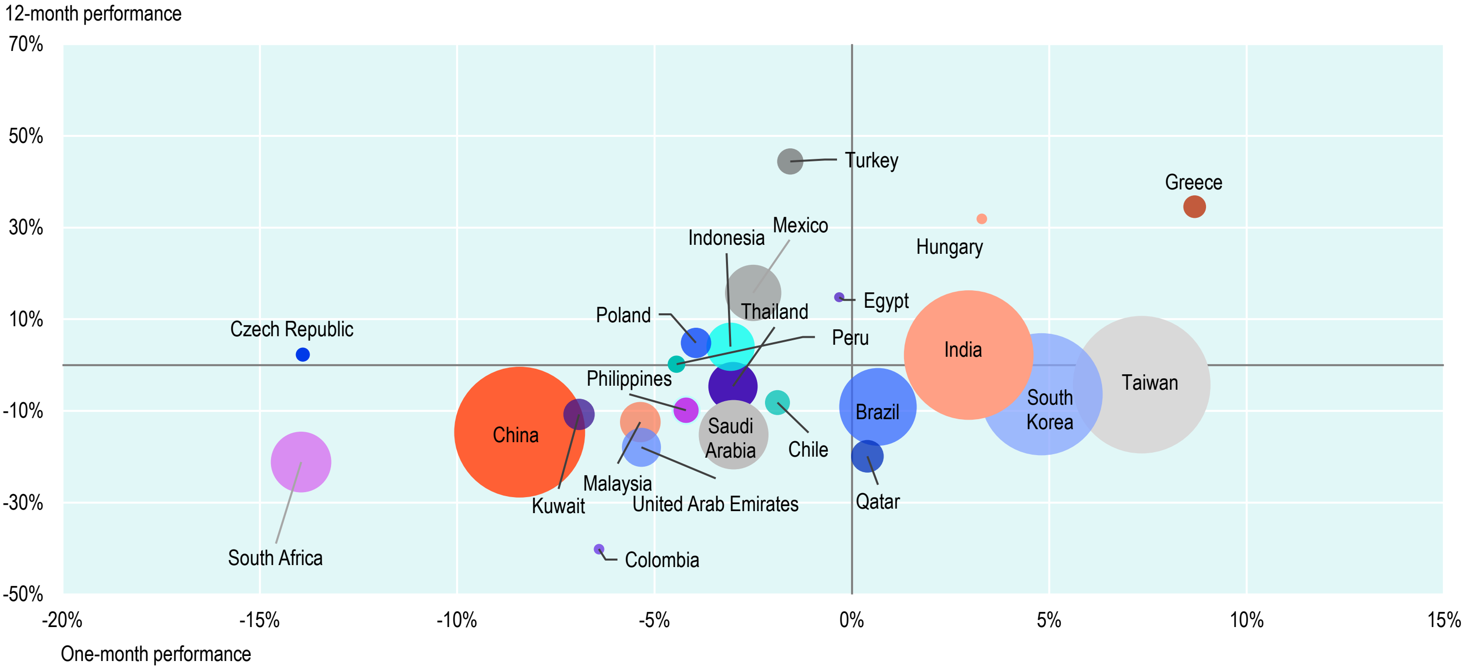
# A greener future

## Emerging Markets Insights

Exhibit 1: Emerging Market Country Performance

As of May 31, 2023




Sources: FactSet, MSCI. Note: Bubbles size reflect relative market capitalization, ex China, which is resized to 50% of actual market capitalization. Performance as represented by individual/respective MCSI country indexes. 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.** For illustrative purposes only and not reflective of the performance or portfolio composition of any Franklin Templeton fund.

## Three things we're thinking about today

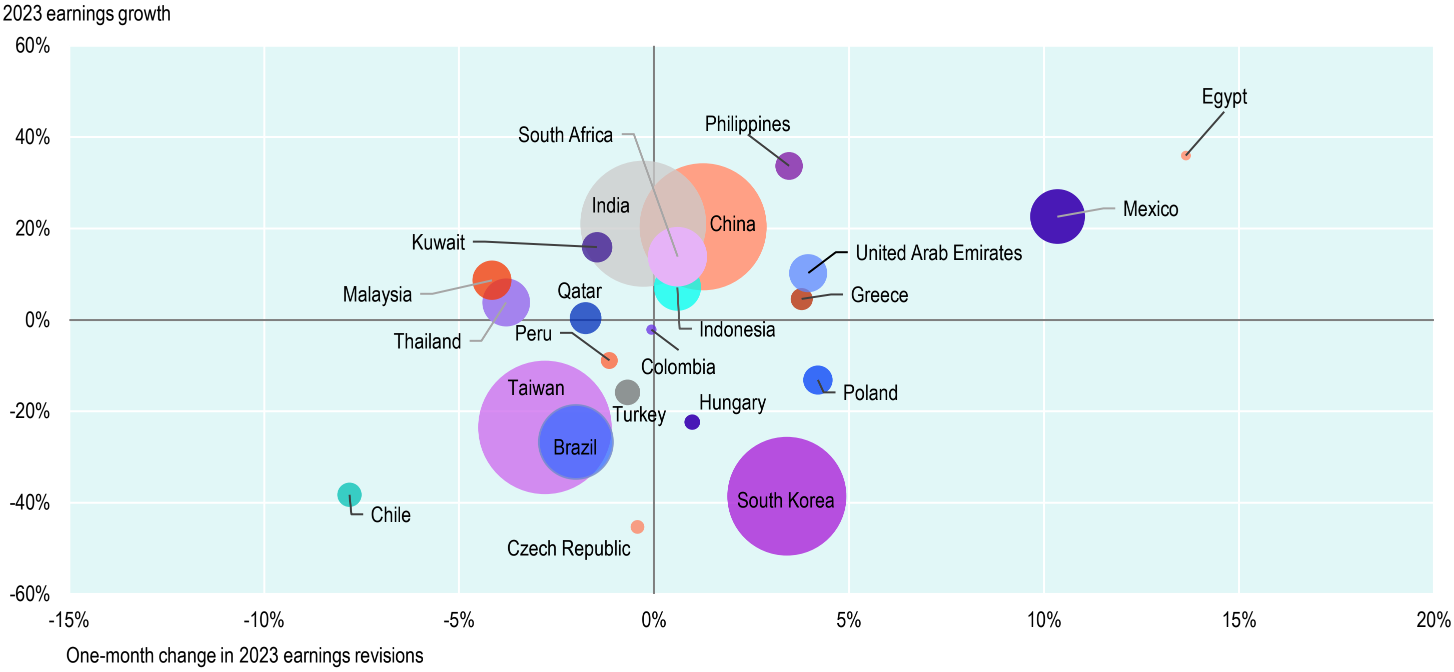
1. **Artificial Intelligence (AI) is driving increased chip demand.** Semiconductor chip design company NVIDIA announced earnings in its fiscal second quarter are expected to surge 52% to US$11 billion on demand for its chips which support AI algorithms and large language models similar to Chat-GPT. The announcement drove the Philadelphia Semiconductor Index up 10%.[1] NVIDIA is a "fabless" chip company, meaning it designs chips, but does not manufacture them. The fabrication plants that do the manufacturing for such companies are mostly based in Asia and are direct beneficiaries of the surge in demand for chips that can support the coming AI revolution. This is expected to have a positive impact on the semiconductor ecosystem throughout Asia, ranging from chip manufacturers in Taiwan and South Korea to chip packaging companies in Malaysia, as well as those companies producing the chemicals and precision parts used in the lithographic machines that produce the chips from silicon wafers.

2. **China cuts deposit rates.** Chinese banks recently cut deposit rates to support bank profitability and ensure that loan targets are met. Net interest income contributes c. 70% of Chinese bank revenue,[2] and prior cuts in lending rates without corresponding cuts in deposit rates have put downward pressure on revenue. Deposit rates were cut 30-50 basis points for corporate and retail depositors. The rate cuts are expected to stimulate household consumption as well as support bank loan growth and return on equity. Unofficial targets of 10% loan growth and a 30% payout ratio amongst the "Big Four" Chinese banks imply the need for a return on equity of 10%-12%, which was at risk from the downward pressure on net interest margins. Maintaining credit growth is important for the economy given its dependence on bank credit, as opposed to other channels for recycling the large pool of household savings.

3. **Emerging market fund flows.** Following a lackluster start to the year, foreign investor flows to emerging market (EM) equities surged in May. Data from Lipper indicates US$2 billion in inflows between May 3-24, a positive signal. Equity fund flows to India were notable, rising to a nine-month high in the month. The improved sentiment towards EMs may reflect the valuation gap relative to developed market equities as well as diverging growth expectations for the second half of 2023. Current consensus expectations call for the United States and Europe to enter a recession, but growth in emerging markets looks likely to remain resilient.

Exhibit 2: Earnings Per Share (EPS) and Earnings Revisions

As of May 31, 2023




Sources: FactSet, MSCI. Note: Bubbles size reflect relative market capitalization, ex China, which is resized to 50% of actual market capitalization. Performance as represented by individual/respective MCSI country indexes. 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.** For illustrative purposes only and not reflective of the performance or portfolio composition of any Franklin Templeton fund.

## Outlook

We see a clear trajectory toward a greener future in EMs amidst country commitments to net zero[3] and the emergence of climate-friendly technologies. Evidence of this lies in metrics related to the transition. For example, investments in solar power are expected to outpace investment in oil production in 2023.[4] EM economies including India, Brazil and the United Arab Emirates have invested heavily in clean energy, district cooling and decarbonization.

We believe the transition to a greener future—a shift toward sustainable economic growth—is a megatrend that presents significant investment opportunities in environmental technologies related to renewable energy, decarbonization and electric vehicles (EVs).

We see beneficiaries of this green transition in companies that we invest in. The growth of the EV market, renewable energy and the increasing popularity of green construction methods and materials are some examples of this transition. Semiconductors also play an integral part, where they are used to convert and manage the transmission of energy. Within Asia, we see well-run market leaders in the upstream and downstream supply chains of EVs, solar equipment and construction materials poised to benefit from this trend. Outside of Asia, Brazil's state-run oil company aims to focus on renewable energy projects, and the largest renewables producers in the Middle East have lifted capacity to new highs in 2022.

The ability to ready ourselves alongside these evolving trends stems from our focused investment approach, which enables our on-the-ground teams to identify business models and management teams that display agility and resilience in a fast-changing world. This local presence also helps us build local relationships and gives us the credibility to engage in effective long-term dialogue with management teams to generate better potential outcomes for all our stakeholders. We have built considerable expertise in the EM equity asset class, which we believe gives us the ability to identify investment opportunities before our peers.

## EM key trends and developments

EMs fell during the month of May, faring worse than their developed market counterparts. The US debt ceiling negotiations largely dictated market sentiment globally, although developments in selected local markets also impacted overall performance.

For the month, the MSCI Emerging Markets Index fell 1.65%, while the MSCI World Index fell 0.92%, both in US dollars.[5]

## The most important moves in EMs in May 2023

Equities in the emerging Asian region fell overall during the month, but a gain in semiconductor stocks from a positive outlook stemming from artificial intelligence-fueled growth sparked gains in the technology-heavy markets of South Korea and Taiwan. India's equity market also traded higher after a local court panel found no conclusive evidence of stock price manipulation within the Adani group. China's market led regional losses; a selloff in technology stocks due to profitability concerns from increased competition contributed to the decline. Geopolitical tensions, a disappointing post-COVID-19 recovery and deficiencies in audits of US-listed Chinese companies also weighed on Chinese equities.

Latin America was the best performing region—albeit still registering a decline—with heavyweight Brazil being the sole advancer. The finance minister's nomination of Gabriel Galipolo for a top position at the central bank, and the convergence in opinion between the president and central bank in terms of possible rate cuts introduced some stability to the political and economic fronts. Markets also welcomed the approval of a new fiscal framework bill. However, the financial results of Bancolombia, which underwhelmed investors, pressured Colombia's market,

The Europe, Middle East and Africa region was the worst-performing region. Equity markets in South Africa and Saudi Arabia both fell, and all sectors in the MSCI South Africa Index declined, with energy and financials bearing large losses. Prevailing power cuts continue to eat into corporate earnings, while the prospect of lower interest rates partly affected financial stocks. In Saudi Arabia, a fall in Saudi Aramco's latest quarterly profits led to a drop in its share price. Conversely, Greek stocks posted large gains after the incumbent party won the parliamentary election. The current prime minister is viewed as market-friendly and equities rallied on hopes that the nation can regain its investment-grade status under his leadership.

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**Endnotes**

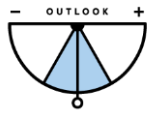
1. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results**.
2. Source: FactSet.
3. Net zero is defined as cutting greenhouse gas emissions to as close to zero as possible, with any remaining emissions re-absorbed from the atmosphere, by oceans and forests for instance.
4. Source: International Energy Agency's World Energy Investment 2023 Report.
5. 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. Source: Bloomberg, November 30, 2022. There is no assurance that any estimate, forecast or projection will be realized.
7. Source: Bloomberg, Saudi Arabian government.
8. Source: Bank of Thailand.

**Index Definitions**

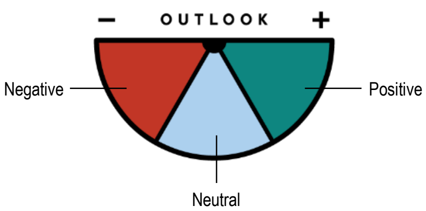
1. The **MSCI EM Latin America Index** captures large- and mid-cap representation across five emerging markets (EM) countries in Latin America.
2. The **MSCI Emerging Markets EMEA Index** captures large- and mid-cap representation across 11 emerging markets (EM) countries in Europe, the Middle East and Africa (EMEA).
3. The **MSCI EM Asia ex Japan Index** captures large- and mid-cap representation across two of three developed markets (DM) countries (excluding Japan) and eight emerging markets (EM) countries.
4. The **MSCI Arabian Markets Index** captures large- and mid-cap representation across 11 Arab markets countries. With 88 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

# Regional outlook

Three-month period ended March 31, 2023

| Market | Conviction | Investment Thesis |
|---|---|---|
| **Latin America** | | |
| **Brazil** |  | The economy has been recovering which is driving earnings growth, but high inflation persists, and interest rates may remain higher for longer. A new government with overspending policies could complicate matters. External environment could be a swing factor for better or worse. Sustainability of long-term growth would be helped by additional economic reforms, privatizations and concessions. More profound economic reforms should provide the basis for higher long-term economic growth and a better business environment for companies. |
| **Mexico** |  | The consumer confidence index rose in February, adding to the recovery in January. The index has now increased for six consecutive months. Balancing this was the forward-looking index measuring the expectation for the household in 12 months, which declined. Business confidence in the manufacturing sector recovered in February, adding to the improvement in January and rising to a post pandemic high. |
| **Peru** |  | While public sentiment has been moving toward more moderate positions, the high fragmentation of the political spectrum makes it difficult to form a strong popular-backed government. Institutions will continue to work in Peru as there are not enough political seats numbers to change the status quo, but the confidence to launch long-term projects has been undermined. |
| **Emerging Europe** | | |
| **Czech Republic** |  | While we believe the country has been managed better than Poland or Hungary, the slowdown in Germany and high energy prices in Europe will put pressure on the Czech Republic in 2023. |
| **Hungary** |  | Economic sentiment remains weak as economic growth is under pressure due to weakness in the industrial sector and the tightening of monetary policy. GDP is expected to increase 2% in 2023 if there are no energy shortages, with a downside scenario of a 4.5% decline in GDP if there is a protracted disruption in energy flows from Russia. |
| **Poland** |  | Private consumption should support GDP growth in 2023, and the economy will likely grow by 4.5%. Growth is 2023 is forecast to be 2.4%. A worst-case scenario based on a protracted disruption to energy flows from Russia could result in a 2% drop in GDP growth in 2023.[6] |

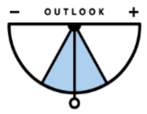
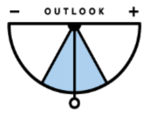
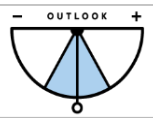
### Understanding the Pendulum Graphic




The graphic reflects the views of Franklin Templeton Emerging Markets Equity regarding each region and are updated on a quarterly basis. All viewpoints reflect solely the views and opinions of Franklin Templeton Emerging Markets Equity. Not representative of an actual account or portfolio.

# Regional outlook

Three-month period ended March 31, 2023

| Market | Conviction | Investment Thesis |
|---|---|---|
| **Middle East** | | |
| **Kuwait** |  | Strong fiscal position, but delay in reform and issuance of a debt law leaves the sustainability of the longer-term fiscal path in question. Rich valuations and a weak growth outlook lead us to a negative market view, although a potential surprise on the debt and mortgage laws can be short-term positives for the market. |
| **Qatar** |  | Liquefied Natural Gas (LNG) production expansion is the central theme for next 3-4 years. Qatar offers solid stability due to its high reserves and a low oil budget-breakeven point. However, over a medium to longer term, the economy requires diversification to reduce its reliance on the energy sector. |
| **Saudi Arabia** |  | The outlook is improving but remains anchored to normalization of economic activity, oil prices and PIF/private sector spending. Forex reserves (c. $US450 billion) and PIF assets ($US360 billion) lends comfort.[7] |
| **UAE** |  | High surpluses set the stage for the government to push its growth agenda. Over the medium term, oil production capacity increase in Abu Dhabi and increasing population in Dubai bode well for growth trajectory. Privatization/IPO program in Dubai and Abu Dhabi is helpful in increasing capital market depth. |
| **Emerging Asia** | | |
| **China** |  | China reached an inflection point with the easing of access to credit for the real estate sector in October. This was followed by a significant reset in US-China relations at the G20 meeting in Bali in November. The final catalyst is the dismantling of China's zero-COVID policies. |
| **India** |  | We believe the market is expected to move sideways over the next 6-12 months as roll forward of earnings is likely to be offset by further valuation correction and some cut to consensus estimates. Long-term themes such as under-penetration, formalization and stable government remain intact, however. Global commodity prices will be a key to monitor. |
| **Indonesia** |  | Elevated commodity prices provide an economic tailwind, with resilient domestic demand growth trends lending support. |
| **South Korea** |  | US recession risk and weakness in the semiconductor sector are weighing on sentiment. Political tension with North Korea remains elevated. |
| **Taiwan** |  | Cross-strait geopolitical risks are a known factor for the market. We keep the status-quo assumption unchanged, despite the Russia/Ukraine war, which has raised concerns of the potential relationship deterioration between China and Taiwan. The corporate outlook has turned more negative amid weakness in the semiconductor sector. The increasing tensions between United States and China is an overhang for the corporate sector. |
| **Thailand** |  | Overall, the outlook appears stable to us. Domestic consumption could experience some tailwinds as the economy reopens, though there are some concerns on inflation amid geopolitical uncertainties. We anticipate a gradual tourism recovery as China dismantles its zero-COVID policy. Pre COVID-19, arrivals from China accounted for 25% of total tourist arrivals.[8] |

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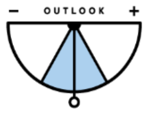
# Regional outlook

Three-month period ended March 31, 2023

| Market | Conviction | Investment Thesis |
|---|---|---|
| **Africa** | | |
| **Egypt** |  | Prepare for further currency depreciation and higher interest rates. IMF deal along with the Gulf Cooperation Council and other multilateral support is positive, yet the amount isn't enough, in our view. The IMF is stressing for the government to agree increasing private sector's involvement and a flexible currency. Execution of reforms on these fronts in next 12 months is paramount, of which privatization deals have begun but more is expected. |
| **Kenya** |  | While we believe valuations are cheap, the outlook remains tough given the foreign exchange crisis, high inflation and challenging global backdrop. |
| **Nigeria** |  | The risk of further currency weakness remains high and the weak political and macro environment creates a weak environment for stocks. The cost of subsidies presents a challenge to the government's fiscal position as it limits room for infrastructure spending. |
| **South Africa** |  | The near-term outlook is getting questioned amid global risks such as inflation, interest-rate hikes and Chinese demand. We believe a long-term recovery is still dependent on the ability of the government to execute and commit to other reforms. |

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## Franklin Templeton Emerging Markets Equity

### Local knowledge, global reach

In a sea of overlooked and under-researched companies, there's no substitute for local market knowledge. Our on-the-ground investment team of 72 portfolio managers and analysts across nearly 13 countries distinguishes Franklin Templeton Emerging Markets Equity from the crowd. Investors benefit from our networks of local business contacts, access to in-person company visits and real time response to local market events.

Our global reach through Franklin Templeton Investments provides access to sophisticated risk management and trading resources. Portfolio management collaborates closely with the Investment Risk Management Group, which provides detailed risk analytics to complement the team's assessment of risk exposures.

- **72 portfolio managers and research analysts**
- **18 years on average of industry experience**
- **9 years on average with Franklin Templeton**

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