PERSPECTIVE

Monetary Easing Prevalent in Emerging Markets in the Third Quarter

October 10, 2019

The US-China trade conflict has remained at the forefront of investor concerns in recent months, with both governments imposing tariffs on each other's goods. While continued tensions are likely to result in continued market volatility, Franklin Templeton Emerging Markets Equity nonetheless finds reasons to be positive about emerging markets, with a more dovish global central bank backdrop offering support.

Three Things We're Thinking About Today

1. Finance Minister Nirmala Sitharaman announced a meaningful reduction in **India's corporate tax rates** to help spur investment and boost growth in the country's slowing economy. These changes came as a positive surprise and send a strong signal that the government has recognized the stress that corporates face from weak sentiment and subdued economic activity. While there has been some concern that the measure will result in a decrease in revenues, we believe there are mitigating factors that could reduce the loss in revenues. It is also important to note that the level of impact differs from sector to sector, particularly in sectors subjected to the highest effective tax rates. For instance, banking would be a key beneficiary as it is a full-tax paying industry. Most consumer companies also benefit from the corporate tax cuts. However, companies that currently receive tax relief or incentives from the local state government will not benefit as much. Overall, we think India's corporate tax cuts should help spur investment over the longer term. We continue to favor companies that can benefit from secular growth drivers such as favorable demographics, infrastructure investment, urban and rural consumption growth and increasing income levels.
2. China recently announced the removal of the investment quotas under its Qualified Foreign Institutional Investor (QFII) and RMB Qualified Foreign Institutional Investor (RQFII) programs. Increasing market access for foreign investors has been an ongoing process, as China undertakes structural reforms to its capital markets and allows foreign firms greater control over their assets. The move also follows a recent decision to allow foreign financial firms an option to take majority stakes in joint ventures. Certainly, the lifting of these restrictions on **foreign investment in China** was a welcome surprise. However, we think it is unlikely to have a dramatic impact in the short term because the existing quota system was underutilized. If we see further measures to liberalize and enhance market access that will encourage index providers such as MSCI and FTSE to increase the inclusion factor, we think China's weighting in global benchmark indexes will invariably rise, and passive funds may have no choice but to step up their purchases of Chinese securities. While the overall immediate impact of China's move to lift restrictions on foreign investment may not be drastic, we think the initiative signifies China's commitment and long-term strategic decision to further increase access to its financial markets.
3. Optimism surrounding the government's economic agenda, including the key social security reform, has resulted in a more favorable climate in **Brazil**. While the country's economic recovery has been slower than expected, with the government forecasting gross domestic product (GDP) to grow by 0.85% in 2019, government and central bank efforts could improve the country's longer-term GDP growth potential.[1] Inflation has also remained under control, allowing the central bank to lower interest rates to record-low levels to stimulate the economy. We believe the approval of pension system reform is key to stimulating

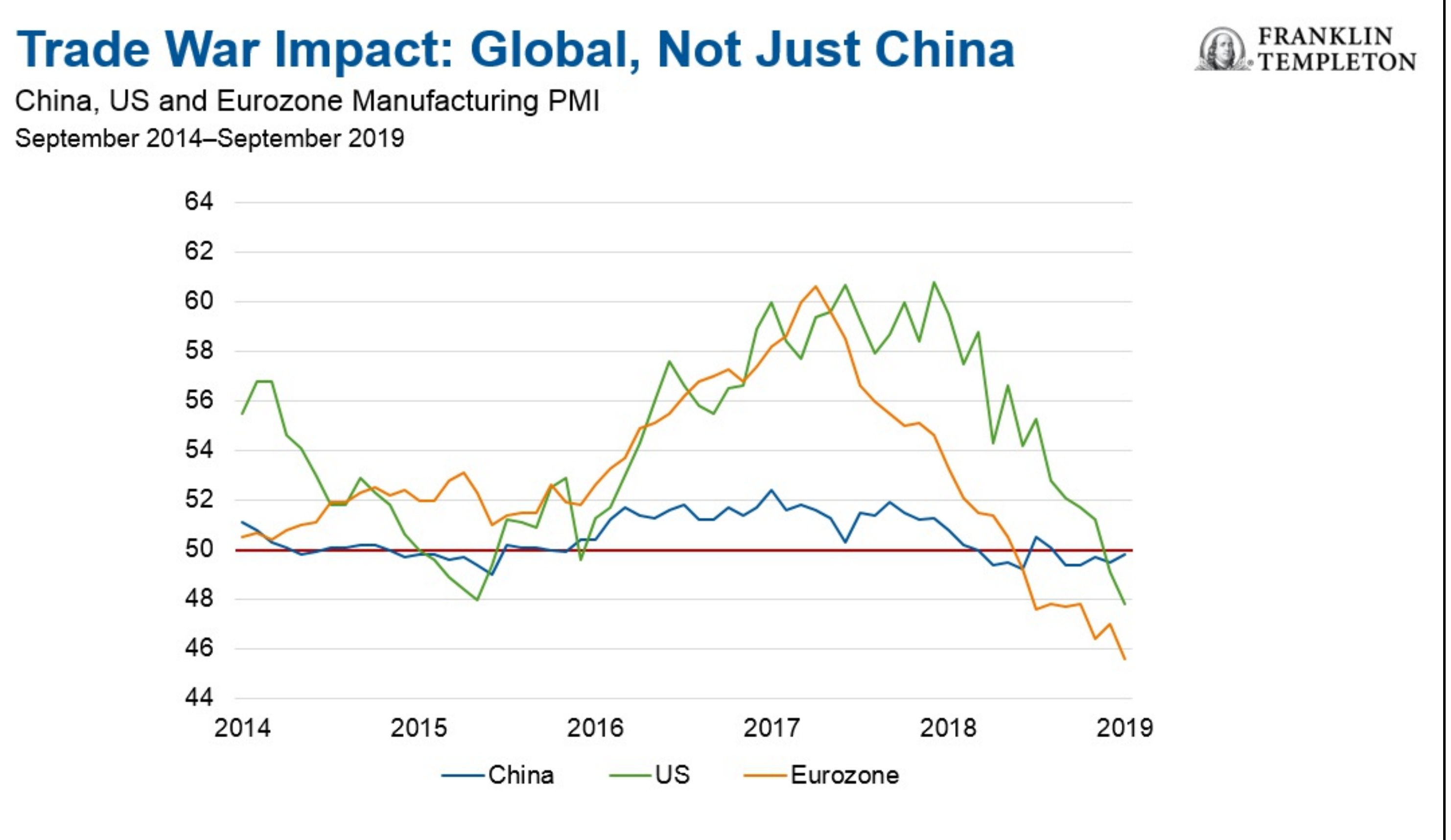
investment and credit, which should help improve economic activity, as well as help significantly reduce Brazil's fiscal deficit. A major privatization plan has also been announced, and we expect tax and other reforms that could improve the ease of doing business to follow. We maintain a positive outlook on the equity market and continue to have a favorable view on domestic-oriented themes, including financials and consumer-related sectors.

Outlook

The US-China trade conflict has remained at the forefront in recent months, with both governments imposing tariffs on each other's goods. However, it should be emphasized any impact of the trade war has not been limited to China; rather, we have seen a global impact. While the resumption of trade talks expected in October indicates the willingness of both sides to work toward resolving outstanding issues, we remain cautious and expect continued volatility in the interim.

Political turmoil in the United States following the launch of an impeachment inquiry on the US President Donald Trump added to increased market volatility in the interim. However, reduced expectations of further escalation led investors to refocus on the US-China trade dispute and US Federal Reserve (Fed) policy. The Fed has reduced its benchmark rate twice in the last three months, with expectations rising for another rate cut by the end of 2019.

Slowing economic growth expectations, declining inflationary pressures and easing monetary policy in developed economies, including the United States and the eurozone, have led central banks in emerging markets (EMs) to generally turn more dovish this year. We expect this trend to continue with rate cuts in a number of larger EMs, including India, Brazil, Russia and Mexico. Coupled with improving earnings expectations and relatively undemanding valuations and dividend yields, we believe the outlook for EM equities remains attractive.



Source: Bloomberg, September 2019. The Purchasing Managers Index (PMI) measures manufacturing trends. A reading below 50 indicates contraction while a reading above 50 represents expansion.

Emerging Markets Key Trends and Developments

Stock markets worldwide weathered a volatile quarter amid bumpy US-China trade negotiations and global recession fears. Central banks in several major markets, including the United States, cut interest rates to support economic activity. EM equities declined in US-dollar terms, while developed market stocks recorded a modest gain. EM currencies as a whole fell against the US dollar. The MSCI Emerging Markets Index lost 4.1% over the quarter, compared with a 0.7% return in the MSCI World Index, both in US dollars.[2]

The Most Important Moves in Emerging Markets in the Third Quarter of 2019

Most Asian markets finished the quarter lower as trade tensions clouded the economic outlook for the region. The US-China trade row remained in focus—both countries announced more tariffs in August but made conciliatory moves in September. An escalating trade dispute between South Korea and Japan added to market uncertainty. Stocks in China and South Korea retreated. In India, equities fell as the economy's momentum faltered, though corporate tax cuts and other stimulus measures helped stem the decline. Bucking the downtrend, Taiwanese equities rose. Suppliers to Apple were lifted by encouraging pre-orders for the latest iPhone.

Markets in Latin America declined over the quarter with Argentina, Peru and Chile leading the way down. Although declining, Mexico and Brazil performed better than their regional peers. Despite a rebound in September, the Argentine market lost nearly half its value in US dollar terms over the three-month period on increased political uncertainty, debt re-profiling and the imposition of capital controls. Market turmoil, however, remained largely contained to Argentina. Brazil's central bank lowered its key interest rate by 100 basis points to an all-time low of 5.5% to stimulate the domestic economy. Progress on the reform front further supported investor confidence. In August, Mexico's central bank reduced its benchmark interest rate for the first time in more than five years, citing weak domestic growth and lower inflation.

The Europe, Middle East and Africa region as a whole lagged their EM peers in the third quarter. South Africa and Poland were among the weakest performers, ending the quarter with double-digit losses. Turkey and Egypt, in contrast, recorded strong returns, while the United Arab Emirates (UAE), Qatar and Russia also outperformed regional peers. The South African Reserve Bank left interest rates unchanged in September, following a 25 basis-point cut in July, as it continued to balance economic growth concerns and inflation expectations. A weaker South African rand also pressured returns in US dollar terms. Attractive valuations in Russia and the UAE supported investor sentiment with some comfort, while a larger-than-expected 150 basis point interest-rate cut amid a downward inflation trend drove returns in Egypt.

Regional Outlook
As of September 30, 2019

ISO Code	Country	Sentiment Score	Opinion
CN	China	0	Economic conditions could remain soft as the trade dispute is unlikely to be resolved in impact on the IT sector as supply chains may need to be reshuffled. The government's s nature and have been credible. Interest-rate cuts are expected, but the pace may disap positive if trade talks progress well or the government's supportive measures prove to b
IN	India	0.5	Long-term fundamentals including under-penetration, formalization of the economy and deficit and improving corporate earnings (aided by recent tax cuts) are offset by high va
KR	South Korea	0.5	Macro indicators remain sound. However, concerns about government regulations are g
PK	Pakistan	0	Uncertainty remains, with concerns including a structurally weak economy with high tra
			The US-China trade dispute brings uncertainty to the market. The restrictions on Huawe

TW	Taiwan	0.5	are engaged. Weaker-than-expected IT product demand is also worrying. Fundamentals market has already corrected, pricing in these negative factors, and we believe some va
VN	Vietnam	0.5	The International Monetary Fund (IMF) estimates 2019 GDP growth at 6.5%, underpinne Risks include a slowdown in exports and investment.
CZ	Czech Republic	0.5	The Economic Sentiment Indicator (ESI)) rose to 104.6 in August from 103.9 in July, risin average of 104.9. The improvement was mainly driven by services confidence, which re
HU	Hungary	0.5	Economic performance has generally been in line with sentiment, which has signaled a however, indicated a sharp pick-up from July to 111.8. The gain mainly came from servi
PL	Poland	0.5	The ESI remained unchanged at 102.2 in August compared with July, and in contrast to confidence rose to 1.1, exceeding its six-month average of 0.7, while retail trade confid
RU	Russia	0.5	In a stable oil price/ruble environment, domestic names should likely benefit due to earn remain stable with the next presidential election scheduled for 2024. However, macro ri and the possibility of additional US/EU sanctions.
AR	Argentina	0	
BR	Brazil	1	The new government's emphasis on implementing ambitious economic reforms could p for companies.
MX	Mexico	0.5	It is difficult to assess if the glass is half full or half empty with President Andrés Manuel macroeconomic stability, his autocratic ruling method leaves the door open to the lack populism and rationality.
KW	Kuwait	0.5	MSCI upgrade to EM status (to be implemented in May 2020) could be a strong catalyst peers and hence more defensive. A persistent risk is political deadlock, which often lea
SA	Saudi Arabia	0.5	The Index inclusion upgrade story is behind us now. The focus has returned to fundame performance.
AE	United Arab Emirates	0.5	Within the region, the UAE is least dependent on oil revenues. Fiscal reforms such as th however, needs to be monitored closely.
EG	Egypt	0.5	Egypt has made a committed step toward economic reforms. It is witnessing receding i
KE	Kenya	0.5	Our outlook remains neutral to positive. The IMF expects around 6% GDP growth for 20
NG	Nigeria	0	The market is improving from a macro perspective with higher oil production, steadying President Buhari, however, remain low. Concerns regarding investment into Nigeria als
ZA	South Africa	0	The outlook remains muted and dependent on the government. 2019 is likely to be toug
QA	Qatar	0.5	Risks include slowing economic growth, political conflict and deadlock and continued we

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

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What Are the Risks?

All investments involve risks, including the possible loss of principal. Investments in foreign securities involve special risks including currency fluctuations, economic instability and political developments. Investments in emerging markets, of which frontier markets are a subset, 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. Because these frameworks are typically even less developed in frontier markets, as well as various factors including the increased potential for extreme price volatility, illiquidity, trade barriers and exchange controls, the risks associated with emerging markets are magnified in frontier markets. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions**.**

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1. There is no assurance that any estimate, forecast or projection will be realized.

2. Source: Source: MSCI. The MSCI Emerging Markets Index captures large- and mid-cap representation across 24 emerging-market countries. The MSCI World Index captures large- and mid-cap performance across 23 developed markets. 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 guarantee of future results. MSCI makes no warranties and shall have no liability with respect to any MSCI data reproduced herein. No further redistribution or use is permitted. This report is not prepared or endorsed by MSCI. Important data provider notices and terms available at www.franklintempletondatasources.com.