A Tactical Battle Plan

September 10, 2013

Thomas A. Nelson, CFA
Director of Investment Solutions
Franklin Templeton Solutions

Chinese general and philosopher Sun Tzu famously advised: “Strategy without tactics is the slowest route to victory.” This quote doesn’t just apply to the art of war; investors might do well to let his sage advice sink in, too. It’s the kind of philosophy that guides Tom Nelson, Managing Director of Strategic Allocation within the Multi-Asset Strategies team at Franklin Templeton. Nelson explains how he and his team make asset allocation (or tactical asset allocation) decisions that respond to the ways various asset classes and markets surge and retreat. Nelson, who co-manages Franklin Templeton Multi-Asset Real Return Fund as well as Franklin LifeSmart ™ Retirement Target funds, says strategic allocation refers to the long-term average asset class weights that are used to guide his team in managing portfolios.

“The Multi-Asset Strategies team focuses on three key areas when building and managing our portfolios. One: getting that strategic asset allocation right. Two: tactically tilting portfolios to take advantage of opportunities as well as to avoid potholes. And three: populating our portfolios with what we view as the best managers, funds, and the most optimal combination of those funds to seek to produce strong, risk-adjusted performance over the long term. The process of building portfolios, selecting funds and tilting portfolios is one that we view as being integrated.

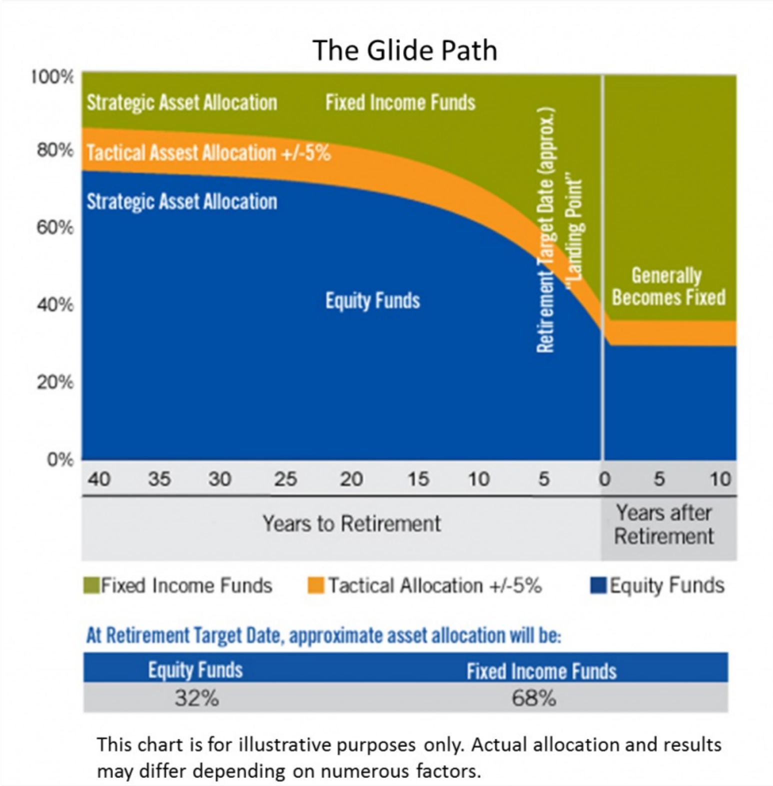
“In Franklin Templeton Multi-Asset Real Return Fund, for example, we have strategic weights across global equities, global fixed income, commodities and cash. We then tilt portfolios against those strategic allocations to take advantage of potential opportunities.

“In the Franklin LifeSmart™ portfolios, we have a strategic allocation referred to as the ‘glide path’ that we believe represents a desirable mix of equities and fixed income throughout an investor’s pre-retirement years, essentially from the beginning of their working years all the way to retirement. We spent an enormous amount of time formulating both our philosophical view on the glide path, or that strategic allocation over time, as well as doing a lot of rigorous, internal quantitative testing. We have implemented a glide path that becomes increasingly conservative as retirement nears, which may help address the competing goals of reaching retirement with the highest expected portfolio value but with the greatest amount of certainty. And it’s the combination of our conservative approach, our robust testing of the glide path design and our tactical approach that helps to differentiate us.”

While multi-asset portfolios tend to be built for the long haul, often spanning multiple decades, asset class performance tends to wax and wane through economic cycles.

Nelson says it’s vital to have the ability to tilt portfolios to take advantage of those potential opportunities as they arise or to help reduce potential risks.

“We can be as much as 5% over or underweight our equity or fixed income split in the Franklin LifeSmart™ Retirement Target funds, which allows us to be opportunistic but not so much that we are dramatically altering those portfolios. We also have the leeway to shift allocations within asset classes, for example, between US equities, developed market international equities and emerging market equities. And we utilize mostly those underlying funds as well as a bit of ETFs to make those tactical tilts. That gives us the ability to be tactical.”



Fighting Inflation

The objective of Franklin Templeton Multi-Asset Real Return Fund is to stay ahead of inflation over an economic cycle. Nelson offers his perspective on inflation and why he believes investors should consider allocating a portion of their holdings to a fund like this.

"The fund allocates both to core as well as inflation-sensitive assets, allocating more to inflation-sensitive assets when inflation risks appear high. Right now, we are not overly concerned about inflation pressures in the near term or over the next couple of quarters. However, we feel that an asset mix designed to address inflation concerns is important for nearly all investors and is particularly important for investors who are either nearing or in retirement. Expenses for these investors are going to continue to grow with inflation, and they tend to have growing healthcare needs, where costs have been rising rather rapidly. The Franklin Templeton Multi-Asset Real Return Fund seeks to protect and grow purchasing power through time, that is, a total return that exceeds US inflation over a full inflation cycle, typically five years. And, it does so in a diversified and conservative manner, which is consistent with the risk tolerance of that investor group."

And which is consistent with a strategy based on carefully considered tactics.

To get insights from Franklin Templeton Investments delivered to your inbox, subscribe to the Beyond Bulls & Bears blog.

For timely investing tidbits, follow us on Twitter @FTI_US and on LinkedIn.

What Are the Risks?

Franklin LifeSmart™ Retirement Target Funds
The investment risk of the retirement target funds change over time as its asset allocation changes. Since the funds invest in underlying funds, which may engage in a variety of investment strategies involving certain risks, the Franklin LifeSmart Retirement Target Funds may be subject to those same risks. All investments involve risks, including possible loss of principal. Principal invested is not guaranteed at any time, including at or after the fund's retirement target date; nor is there any guarantee that the funds will provide sufficient income at or through the investor's retirement. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. Bond prices generally move in the opposite direction of interest rates. Thus, as the prices of bonds in the fund adjust to a rise in interest rates, the fund's share price may decline. Foreign investing carries additional risks such as currency and market volatility and political or social instability, risks which are heightened in developing countries. These risks are described more fully in the funds' prospectus. Investors should consult their financial advisor for help selecting the appropriate fund of funds, or fund combination, based on an evaluation of their investment objectives, retirement time horizons and risk tolerance. The funds' risk considerations are discussed in the prospectus.

Franklin Templeton Multi-Asset Real Return Fund
All investments involve risks, including possible loss of principal. Generally, investors should be comfortable with fluctuation in the value of their investments, especially over the short term. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. Bond prices

generally move in the opposite direction of interest rates. Thus, as the prices of bonds in the fund adjust to a rise in interest rates, the fund's share price may decline. Foreign investing carries additional risks such as currency and market volatility and political or social instability; risks which are heightened in developing countries. Because the fund has a significant

investment in Treasury Inflation-Protected Securities (TIPS), it is highly influenced by the TIPS market and the monthly inflation adjustments on these securities. Commodity-linked investments can have heightened risks, including price volatility and less liquidity, and their value may be affected by the performance of broader commodities baskets and markets, as well as supply and demand, weather, tax and other regulatory policies. Because the fund allocates assets to a variety of investment strategies involving certain risks, Franklin Templeton Multi-Asset Real Return Fund may be subject to those same risks. The fund's risk considerations are discussed in the prospectus.