EQUITY

Fundamentals Support Our Positive US Outlook

April 8, 2014

Grant Bowers
Vice President, Portfolio Manager, Research Analyst
Franklin Equity Group®

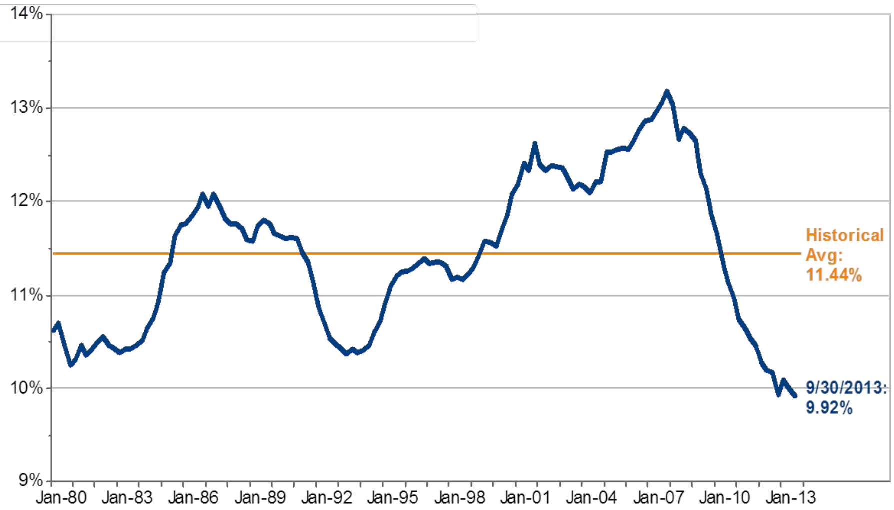
It took a while, but investors finally seem to have shaken off some of the lingering fear that has plagued the US equity market since the 2008–2009 financial crisis. The S&P 500 Index reached a new all-time high in March 2014, which marks the five-year anniversary of the market trough in 2009.[1] Many of the same investors are likely now wondering whether the economy's fundamentals justify the gains, and whether it's time to search elsewhere for opportunities after a five-year run.

Grant Bowers, portfolio manager of Franklin Growth Opportunities Fund, is still optimistic on US equities and dispels talk that the bull market in equities is over. He points to a steadily improving economic backdrop in the United States, strong corporate earnings growth and several big-picture growth themes that support his optimism about the market's long-term prospects. Multi-year growth themes, such as the US energy/manufacturing "renaissance" and the ongoing revival in the real estate markets, complement his investment focus on companies that may be direct beneficiaries of these trends. That said, he cautions that broad market valuations have moved higher and believes an active management approach with careful stockpicking is important in this environment.

The US equity market has benefited over the last five years from a steadily improving domestic economy and a healthy combination of earnings growth and multiple expansion. Despite the market's run, we continue to believe the fundamental case for the US economy and the US equity market remains largely intact. In 2013, we saw strong corporate earnings reports, with many companies reporting record levels of earnings and free cash flow. On the economic front, the data generally continue to improve; unemployment rates are at a five-year low and consumer spending data have been strong. US consumers have generally benefited from the improving economy and low interest-rate environment, increasing their savings rates and lowering their debt costs.

US Household Debt Service Ratios 1980 – 2013

Debt payments as % of disposable personal income, not seasonally adjusted
31-MAR-80 to 30-SEP 13 (Quarterly)



Source: FactSet, The Federal Reserve Board.© 2014 FactSet Research Systems Inc. All Rights Reserved. The information contained herein: (1) is proprietary to FactSet Research Systems Inc. and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither FactSet Research Systems Inc. nor its content providers are responsible for any damages or losses arising from any use of this information.

From our viewpoint at Franklin Equity Group, US stocks have acted rationally over the last five years, reflecting the improving economic backdrop and strong corporate earnings growth we see.

As we look into 2014 and beyond, we remain optimistic about the US equity market's prospects. We expect the fundamental picture of an improving US economy should likely remain intact. We think investors should focus on the competitiveness of US companies in the global market and the fundamental drivers of growth for the US economy.

Valuations: Market Multiples Near Historical Averages

Despite our optimistic outlook, it is fair to say that our focus on buying what we perceive to be quality growth companies at attractive valuations has led us to be more selective as stocks have moved higher. Valuations have increased from the very low levels seen after the global financial crisis and are now approaching the historical averages on many metrics.

Even so, we think the market's valuation level is still reasonably attractive and reflects the positive fundamental backdrop in the United States. We believe it is much more likely that we are in the middle of the business cycle as valuations haven't reached the extreme levels we would expect to see toward the end of a cycle. As of February 28, 2014, the forward price-to-earnings (P/E) ratio of the S&P 500 Index was 15.3 times. Looking at other valuation metrics, such as price-to-free cash flow or price-to-book value, the market also has been trading near long-term averages and does not appear overly expensive, in our opinion.

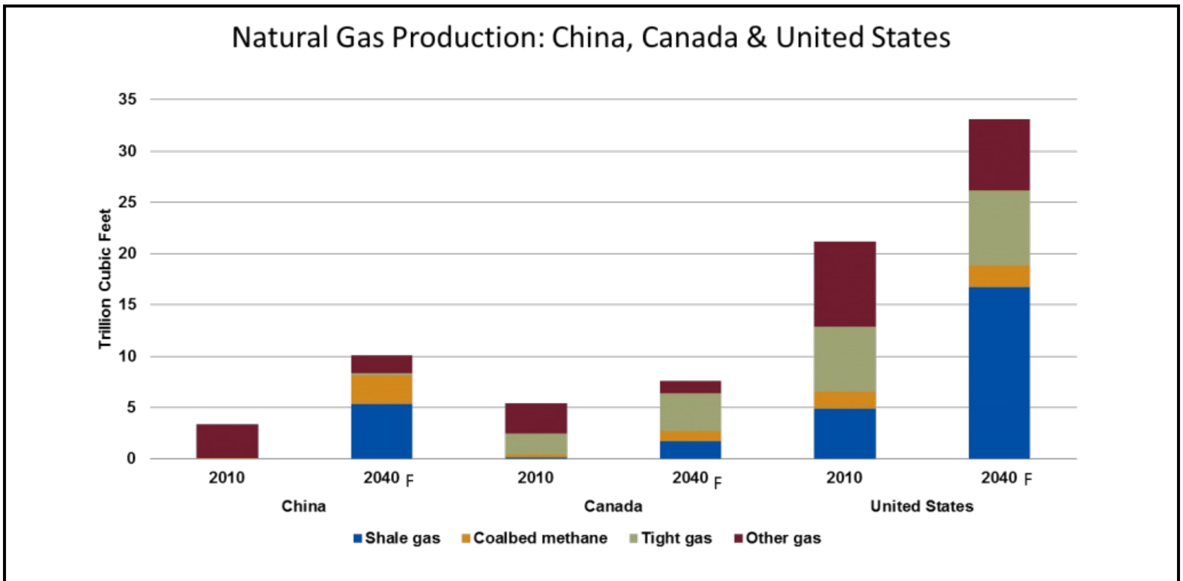
From an investment standpoint, we are being selective but continue to see opportunities to buy high-quality growth companies at attractive prices. Investors should remember that many of the same factors that drove the market higher in the last few years are still in place. These factors include low inflation and accommodative monetary policy around the globe, as well as improving economic data in the United States.

US Corporations Appear Well Positioned in the Global Marketplace

I have long argued that US companies generally look strong, and we have seen many of them emerge from the financial crisis of 2008–2009 stronger, leaner and more profitable than they entered it. We see this scenario represented in the profit margins, earnings and free cash flows being generated today. US companies have taken advantage of the current environment to lower their interest costs, improve productivity and solidify their competitive positions around the globe. We believe many of these improvements should continue to drive growth into the future. Many US companies appear well positioned in the global marketplace, offering some of the world's leading brands and products. As the global economy transitions from recovery to self-sustaining economic growth, we believe many US companies should be well positioned to potentially benefit.

Big-Picture Investment Theme: Energy Renaissance

Taking a longer-term view, we see a number of multi-year growth themes that we believe will benefit the US economy, as well as provide us with potential investment opportunities. One of these themes is the US “manufacturing renaissance,” which appears to still be in its early stage. At the heart of this manufacturing renaissance are the vast shale gas discoveries in the United States over the last five years. These discoveries have changed the energy landscape, lowering energy costs for US companies and consumers to some of the cheapest in the world. These shale gas discoveries are significant and have the potential to impact the US economy for decades. We expect benefits will convey not only to the industrial and energy sectors where large investments will be required, but also to US consumers who could benefit from low inflation, improving employment prospects and lower energy costs for years to come. We believe the access US companies have to cheap energy gives them a structural competitive advantage in the global marketplace. From an investment standpoint, we view the impact of shale gas as a multi-decade tailwind that should benefit the US economy, the domestic consumer and the US equity market.



Source: EIA International Energy Outlook 2013.

Big-Picture Investment Theme: Housing Market Revival

After a very difficult five-year period, the housing market has seen a nice rebound over the last few years. In our view, the backdrop is set for the housing market to contribute to US economic growth in the years ahead. We’re seeing price appreciation in many markets and new buyers returning to the market after sitting out the last few years. Mortgage rates remain generally low, and with home affordability still attractive in many markets, we think there is potential for ownership rates to appreciate over the next several years and for new buyers to return to the market. Housing is an important part of the US economy, and its slow but steady improvement should continue to be a driver of growth going forward.

Grant Bowers' comments, opinions and analyses are for informational purposes only and should not be considered individual investment advice or recommendations to invest in any security or to adopt any investment strategy. Because market and economic conditions are subject to rapid change, comments, opinions and analyses are rendered as of the date of the posting and may change without notice. The material is not intended as a complete analysis of every material fact regarding any country, region, market, industry, investment or strategy.

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

What Are the Risks?

Franklin Growth Opportunities Fund

All investments involve risks, including possible loss of principal. Growth stock prices reflect projections of future earnings or revenues, and can, therefore, fall dramatically if the company fails to meet those projections. Smaller, mid-sized and relatively new or unseasoned companies can be particularly sensitive to changing economic conditions, and their prospects for growth are less certain than those of larger, more established companies. Historically, these securities have experienced more price volatility than larger company stocks, especially over the short term. To the extent the fund 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 fund that invests in a wider variety of countries, regions, industries, sectors or investments. These and other risks are described more fully in the fund's prospectus.

1.Source: S&P Index Data Services. Copyright © 2014, S&P Dow Jones Indices LLC. All rights reserved. Reproduction of the S&P Index Data Services in any form is prohibited except with the prior written permission of S&P. S&P does not guarantee the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions, regardless of the cause or for the results obtained from the use of such information. S&P DISCLAIMS ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P be liable for any direct, indirect, special or consequential damages, costs, expenses, legal fees, or losses (including lost income or lost profit and opportunity costs) in connection with subscribers' or others' use of the S&P Index Data Services. Indexes are unmanaged, and one cannot directly invest in an index. Past performance is not indicative of future results.

Posted in Equity Tagged Franklin Equity Group, Franklin Growth Opportunities Fund, grant bowers, investing in US stocks, mutual funds concentrating in the US, outlook for US equities, US mutual funds legal or tax advice. The information provided in this material is rendered as at publication date and may change without notice and it is not intended as a complete analysis of every material fact regarding any country, region, market or investment.

All investments involve risk, including possible loss of principal.

Investors should carefully consider a fund's investment goals, risks, charges and expenses before investing. To obtain a summary prospectus and/or prospectus, which contains this and other information, talk to your financial advisor, call us at (800) DIAL BEN/342-5236 or visit franklintempleton.com. Please carefully read a prospectus before you invest or send money.

Data from third party sources may have been used in the preparation of this material and Franklin Templeton Investments ("FTI") has not independently verified, validated or audited such data. FTI accepts no liability whatsoever for any loss arising from use of this information and reliance upon the comments, opinions and analyses in the material is at the sole discretion of the user.

Franklin Templeton Distributors, Inc.