ALTERNATIVES

2015 Investment Outlook: Reasons We Still Like Global Equities

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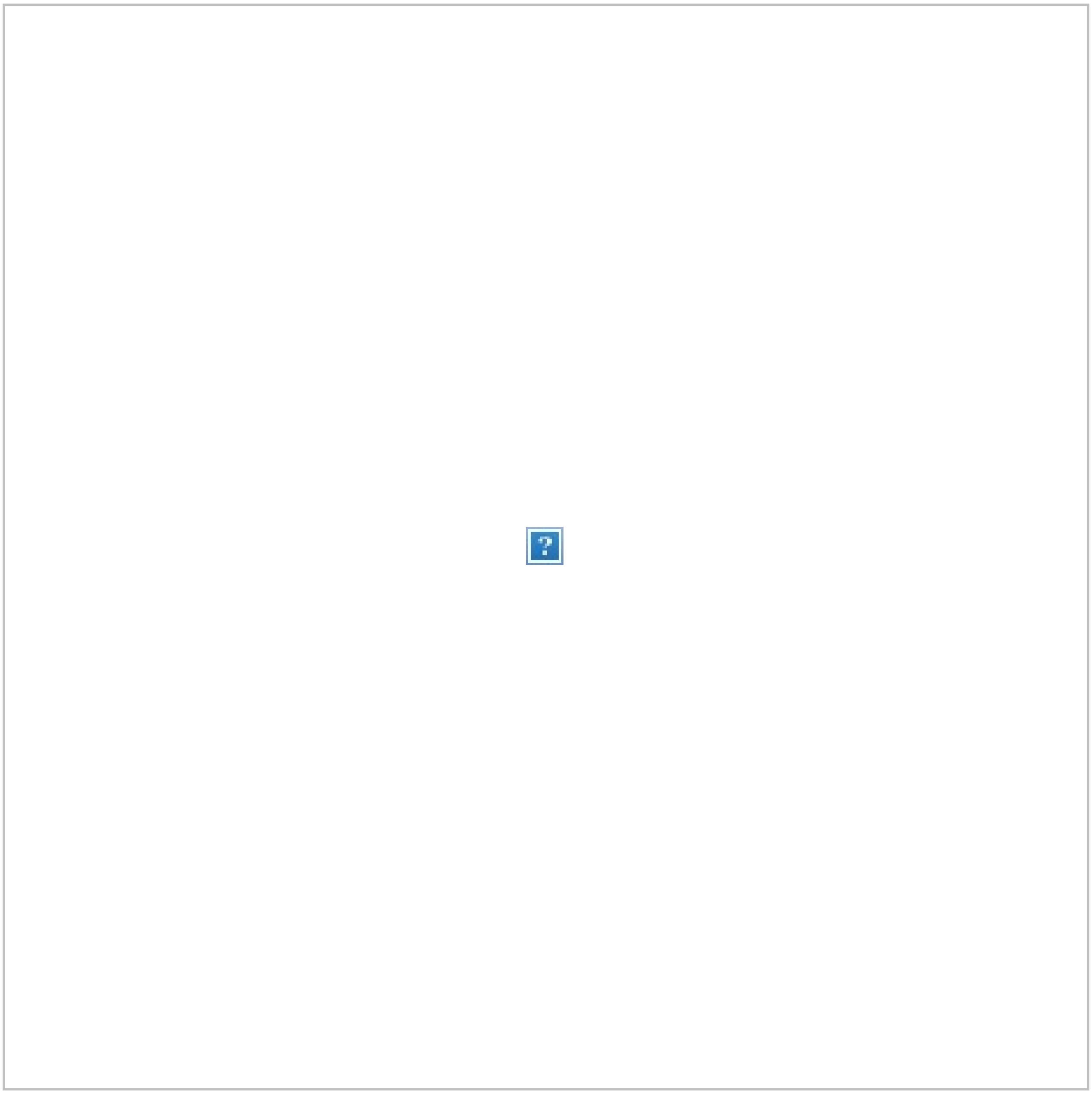
Global trends are converging to present potential opportunities for a variety of asset classes in the new year. Thomas A. Nelson and Brooks Ritchey of Franklin Templeton Solutions provide their insights into what these trends are and which areas of the market they believe may benefit from them.

As we begin 2015, our indicators and analysis suggest global inflation should remain subdued and encourage a liquidity environment that could benefit equities, albeit with the likelihood of a slight increase in price volatility. For example, with low inflation in most developed markets, global central banks will likely maintain low short-term interest rates,



which leads us to favor equities over cash at this time.

In addition, equities have continued to present favorable valuations compared with both developed-market government bonds and local cash rates. The nominal equity dividend yield of the MSCI All Country World Index was greater than the inflation-adjusted yield to maturity of the Citigroup World Government Bond Index in the third quarter of 2014.[1]

Another valuation metric that we leverage is the equity risk premium, defined as the earnings yield minus the appropriate local cash rate. The local equity risk premiums in the United States, Europe, Japan and the United Kingdom were all higher than the long-term average equity risk premiums for each country in recent months, which we believe characterizes a supportive equity environment over cash.

Divergence in regional monetary policy and gross domestic product (GDP) growth rates creates multi-asset investment opportunities, in our view. Within equities, Franklin Templeton Solutions sees opportunities in Japan, emerging Asia and Europe. We continue to favor equities in emerging Asia over emerging Latin America due to what we view as stronger corporate fundamentals and attractive valuations. We believe the United States is transitioning to less accommodative monetary policy while the Bank of Japan's policy has remained highly supportive. Broadly robust Japanese corporate fundamentals and what we view as attractive valuations in Japan as of December-end also lead our Franklin Templeton Solutions team to favor Japanese equities over US equities going into 2015.

We also see opportunities in European equities, largely due to an encouraging recovery in global GDP growth and diverging monetary policy between the Federal Reserve (Fed) and the European Central Bank (ECB). Most components of global composite purchasing managers index data (a measure of the health of the manufacturing sector) were positive and rising in late 2014, which we believe could help European exporter earnings in 2015. While US monetary stimulus has been decelerating, the liquidity environment in Europe has the potential to benefit regional equities since the ECB appears to us to be open to unconventional measures to help support growth and combat deflation as necessary.

Within fixed income, we believe long-term US interest rates could gradually increase amid a consistently improving growth outlook. We favor short-duration positioning given Fed policy projections, rising US employment, an improving US economy and US Treasury valuations we regard as stretched. We favor US high yield over intermediate-term US Treasuries as interest coverage ratios have improved over the last few years, with many companies lowering their borrowing costs and increasing their cash holdings. Since many US corporations built large cash reserves and extended their debt maturities, we think default rates are likely to remain low in the medium term. We also believe the US high-yield sector has compelling performance potential given the strong US economy.

Hedge funds[2] remain an important tool for us to potentially gain diversification benefits and increase performance potential through strategies that benefit whether the markets go up or down. We also favor hedge funds given the backdrop of potentially rising interest rates, and we are interested in products that target specific market characteristics or anomalies with the goal of generating returns independent of market trends. Additionally, we continue to monitor commodities for opportunities and think oil prices should be moderately higher in 2015 compared to late-2014 lows.

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1. Source: Thomson Reuters (Markets) LLC: Datastream, for period covering 12/31/1987 through 10/31/2014. See www.franklintempletondatasources.com for additional data provider information. Indexes are unmanaged, and one cannot invest directly in an index. **Past performance is no guarantee of future results.**

2. A hedge fund is a pooled investment fund, usually a private partnership that seeks to maximize returns using a broad range of strategies, including unconventional and illiquid investments.

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