FRANKLIN TEMPLETON
INVESTMENTS

What Matters Most

The Case for Active Risk Management

Investors Know Their Priorities

The first priority is usually—

"I don't want to lose my money."

This would probably explain why risk management featured so prominently in a recent survey conducted by Franklin Templeton in partnership with *The Wall Street Journal.*

When respondents were asked what they considered important when choosing investments, risk management topped the list. A close second was the ability to beat the overall market's performance, and thirdly to lose less than the market when it's down.

WHAT INVESTORS SAID IS MOST IMPORTANT TO THEM[1]

57% said:
it's important to **lose less** than the market when it's down

76% said:
it's important to invest in products that **can outperform** the market

83% said:
risk management is important

1. Source: Franklin Templeton/*The Wall Street Journal* online survey conducted among 403 adult investors. The survey was conducted between 11/26/13 and 12/10/13.

Five Reasons Investors Need Active Risk Management

The impact of the global financial crisis reminded people of the importance of risk management. Active management and risk management go hand in hand. In fact, without diligent active management of investments, risk management is typically non-existent.

This brochure presents five reasons why active risk management is crucial for investor outcomes.

1 | Indexes Are Indifferent to Bubbles

Passive investments often follow a market capitalization weighting process that allocates more to potentially overvalued stocks—even when the valuations reach staggering heights.

2 | It's Important to Reduce Your Downside Exposure

Small reductions in downside performance can make a big difference in long-term returns.

3 | Volatility Matters—Especially in Retirement

When combined with consistent withdrawals (aka retirement income), market losses can be significantly harder to overcome.

4 | You Need Real People to Be Able to Apply Real Experience

There really is no substitute for experience when it comes to investing.

5 | Effective Risk Management Requires a Truly Active Manager

Not all actively managed funds measure up the same when it comes to differentiating their portfolios from their benchmarks. Effective risk management requires a truly active approach.

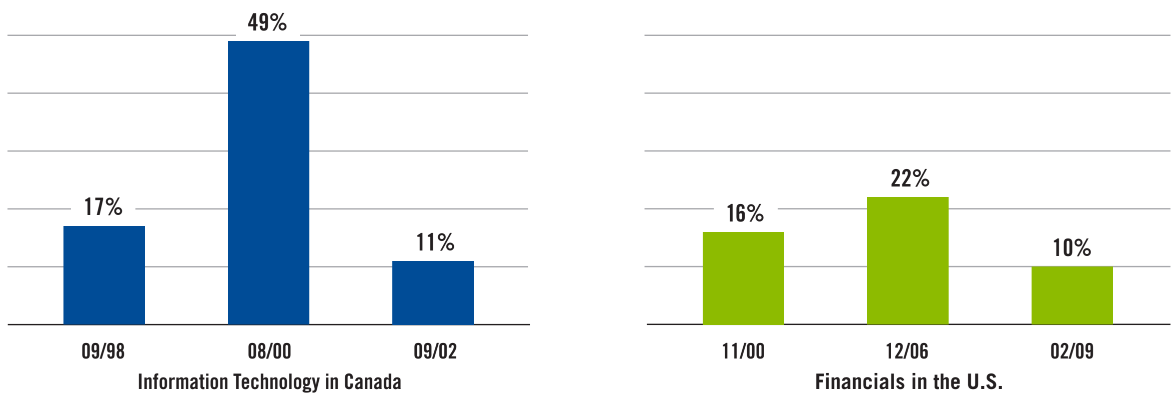
1 | Indexes Are Indifferent to Bubbles

Indexes, and the passive investments that track them, are dispassionate followers of market behaviour. If a sector or region becomes the darling of the day, there is no oversight to counterbalance that sentiment. The charts below show historical stock “bubbles” and their aftermaths, which resulted from the rapid price appreciation of certain segments of the market. As the stock prices in those segments ran up, they became an even greater portion of the index.

Two Noteworthy Sector Bubbles

In periods of rising markets, a market capitalization weighting process that allocates more to potentially overvalued stocks can work to an index return’s benefit. However, when the story changes, as it did in Canada in 2000, when 49% of the S&P/TSX Composite Index was represented by tech stocks, or in the U.S. at the end of 2006, when 22% was represented by financials, this approach can be risky. See below how the index weightings readjusted downward due to sector-specific declines.

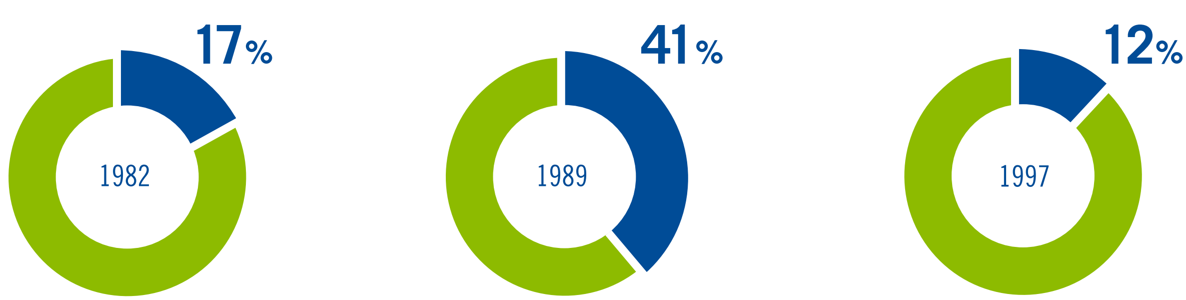
Index Sector Weightings[2]



One Famous Geographic Bubble

Similarly, Japan’s massive run-up in the late 1980s led to a subsequent spectacular collapse. At its height, Japanese stocks composed well over a third of the MSCI World Index.

MSCI World Index Japan Weighting[3]



For illustrative purposes only.

2. S&P 500 – Sources: © 2014 S&P Dow Jones Indices, LLC. All rights reserved.[a] © 2014 FactSet Research Systems Inc.[b] S&P/TSX Composite Index – Source: TMX Market Data Services, Information Technology represented by the Industrials Group prior to 2003.
3. Sources: © 2014 FactSet Research Systems Inc.[b] and MSCI.[c] As of 6/30/14, the MSCI World Index Japan weighting was 8.26%.

2 | It's Important to Reduce Your Downside Exposure

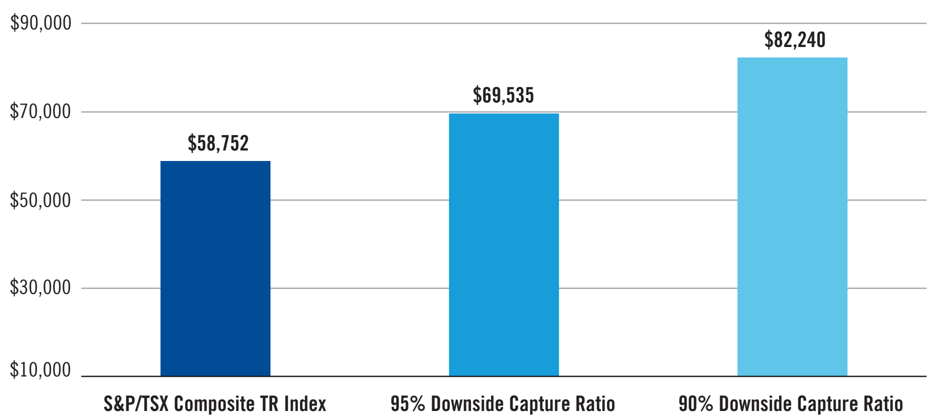
There are good reasons why investors say risk management is so important. But while investors may be more focused on what risk does to their anxiety level, it's probably more important to look at what volatility can do to their bottom line.

Downside capture is a statistic that indicates how correlated a fund is to a market when the market declines. The lower the downside capture, the better the fund has preserved wealth during market downturns. Over time, a lower downside capture can make a significant difference to an investor's portfolio.

LOWER DOWNSIDE CAPTURE CAN MEAN BETTER PERFORMANCE OVER TIME

Hypothetical Growth of a $10,000 Investment[4]

20-Year Period Ended March 31, 2014



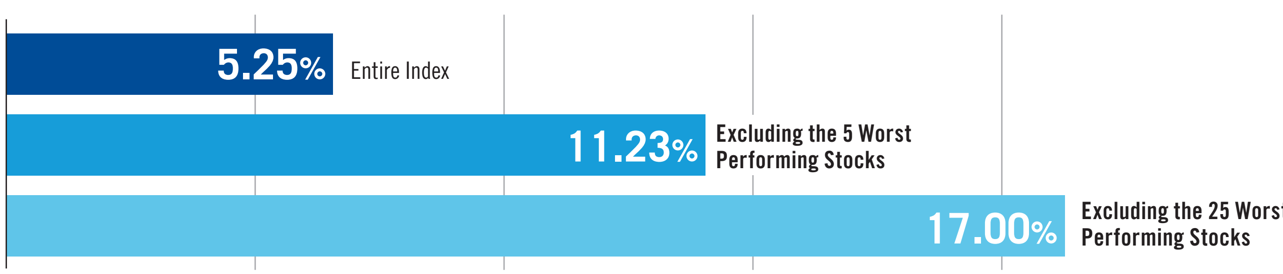
What if the S&P/TSX Composite Index Was Managed for Risk?

With over 250 stocks included in the index, it would be easy to think that performance wouldn't improve that much just by excluding the worst five or even the worst 25 performing stocks in any given year. However, the long-term numbers tell a different story.

AVOIDING THE WORST PERFORMING STOCKS CAN MAKE A BIG DIFFERENCE

S&P/TSX Composite Index Average Annual Total Returns[5]

15-Year Period Ended March 31, 2014



These charts are for illustrative purposes only. Past performance does not guarantee future results.

4. Source: © 2014 Morningstar.[d] Downside Capture Ratio totals were calculated by including 95% and 90% of the S&P/TSX Composite TR Index return for the months when the Index's return was negative.
5. Source: © 2014 FactSet Research Systems Inc.[b]

Indexes are unmanaged and one cannot invest directly in an index.

3 | Volatility Matters—Especially in Retirement

The math behind loss recovery is part of the reason that lowering downside capture is so important. Equal percentage returns on the downside and the upside won't get an investor back to square one. See the recovery gains needed to offset declines in the table below.

Investment Losses Are Experienced Exponentially when Taking Retirement Distributions

The importance of managing risk is heightened by the wave of investors currently nearing or entering retirement. Many will be looking for more than just market accumulation from their investments; they will also be looking for income. When combined with consistent withdrawals (aka retirement income), market losses are significantly harder to recover from.

	Returns Required to Recover Initial Loss	Returns Required to Recover Initial Loss—with a 5% Withdrawal (Over Five Years)
10% LOSS	+11%	+44%
20% LOSS	+25%	+62%
30% LOSS	+43%	+85%
40% LOSS	+67%	+115%

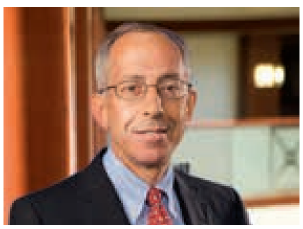
4 | You Need Real People to Be Able to Apply Real Experience

Even the most efficiently run passively-managed index portfolio has no memory of the last bear market, or the last bull market for that matter. There is no learning from mistakes or successes, as these funds are primarily designed to mimic a benchmark.

By contrast, Franklin Templeton mutual funds are guided by some of the most experienced managers in the industry, with average tenure of 10 years at the firm and over 17 years of industry experience.[6]

"The Global Bond Team's unconstrained approach gives us maximum flexibility to not only manage risk, but also to take advantage of global opportunities for investors."

Dr. Michael Hasenstab • CIO Global Bonds • Industry Experience: 19 Years



"We put as much emphasis on understanding an investment's potential downside as we do on evaluating its upside."

Peter Langerman • CEO Franklin Mutual Series • Industry Experience: 37 Years

"Our investors benefit from a time-tested investment process predicated on extensive fundamental research and valuation work."

Garey Aitken • CIO Franklin Bissett Investment Management • Industry Experience: 22 Years

"Risk management has always been an integral part of our investment process at Templeton. We view risk primarily as the permanent impairment of capital, not as short-term volatility. Volatility can actually provide opportunities for investors with a fundamental focus and long-term investment horizon."

Cindy Sweeting • Director of Portfolio Management, Templeton Global Equity Group • Industry Experience: 32 Years

"One of our most popular strategies focuses on companies with consistent and substantial dividend increases. In many ways, the backbone of this strategy is that it not only helps to screen for growth potential, but also downside risk."

Don Taylor • CIO Franklin Value Group • Industry Experience: 32 Years

6. As of June 30, 2014.

5 | Effective Risk Management Requires a Truly Active Manager

Benchmark indexes and portfolios that are modeled after them do not discriminate when it comes to risk potential. This is one reason it is important to know how much an actively managed fund is distinctly different from its benchmark index.

Some funds may actually be "closet indexers," which means they are invested very similarly to their benchmark indexes, while other funds have a composition that is very different from their benchmark indexes. A measurement called "Active Share" can help investors identify truly active managers. Active Share can be a particularly informative metric when looking at funds with broad and diversified benchmark indexes, such as the S&P 500 or the Russell 2000.

Active Share

The portion of stock holdings in an actively managed fund that differs from its benchmark index. Active share:

- Helps to identify "closet indexers"
- Ensures you're getting what you're paying for—active management
- Identifies potential for relative outperformance

THE THREE WAYS THAT ACTIVELY MANAGED FUNDS CAN EARN THEIR ACTIVE SHARE SCORE

		Fund A	S&P 500 Index[7]
1	**HOLD a stock NOT FOUND in the index**	ALBEMARLE	NOT FOUND
2	**NOT HOLD a stock FOUND in the index**	NOT FOUND	NIKE
3	**Hold MORE OR LESS of a stock in the index**	PENTAIR 4.15%	PENTAIR 0.09%

THE ACTIVE SHARE SPECTRUM[8]

For illustrative purposes only. Securities referenced here are not necessarily included in a Franklin Templeton fund.

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8. Graphic: Franklin Templeton Investments. Reference: K.J. Martjin Cremers and Antti Petajisto, How Active Is Your Fund Manager? A New Measure That Predicts Performance, *The Review of Financial Studies* (2009), Vol. 22 (9), pp. 3341–3342. The research focused on U.S. equity funds and their respective indices. It does not provide a perfect measure for equity funds within markets that have fewer securities such as Canada, Australia or various emerging market countries.

"It makes sense that portfolios that are less like indexes lead to performance that is less like an index. So, it seems a safe bet that active share can help investors build better portfolios and have realistic expectations about performance."

–MORNINGSTAR[9]

Investors Have Spoken

As mentioned earlier, the majority of investors participating in the recent Franklin Templeton/*The Wall Street Journal* survey stated that these three things were important to them:

- Losing less than the market when the market is down
- Investing in products that can outperform the market
- Risk management

Franklin Templeton Investments understands why these are priorities for investors. That's why for over 65 years, our firm has used an active management approach.

Franklin Templeton's Active Share Scorecard[10]

Sir John Templeton once said "If you want to have a better performance than the crowd, you must do things differently from the crowd." These days, indexes are a barometer of the investment crowd. Active share scores reveal which active managers are actually investing differently from their benchmark indexes. Franklin Templeton's high average active share scores across our equity fund lineup show that we are truly active managers.

80% = average active share of our **15 largest** equity funds

79% = average active share of our **10 largest** equity funds

75%+ = active share of **15 of 20** equity funds

9. Source: © 2014 Morningstar, *Find Out How Active Your Fund Is*, August 16, 2010. All rights reserved.[d]

10. Source: © 2014 Morningstar, as of March 31, 2014. Franklin Templeton Investments Canada domiciled equity funds. Fund active share scores were calculated versus each fund's primary benchmark index. Templeton Asian Growth Fund, Franklin Flex Cap Fund, Franklin World Growth Fund and Templeton Frontier Markets Corporate Class were not included in this illustration due to insufficient data at the time of calculation.

Franklin Templeton Investments

Gain from Our Perspective®

At Franklin Templeton Investments, we're dedicated to one goal: delivering exceptional asset management for our clients. By bringing together multiple, world-class investment teams in a single firm, we're able to offer specialized expertise across styles and asset classes, all supported by the strength and resources of one of the world's largest asset managers.

Focus on Investment Excellence

At the core of our firm you'll find multiple independent investment teams—each with a focused area of expertise—from traditional to alternative strategies and multi-asset solutions. Across the firm, our portfolio teams share a commitment to excellence grounded in rigorous, fundamental research and robust, disciplined risk management.

Global Perspective Shaped by Local Expertise

In today's complex and interconnected world, smart investing demands a global perspective. Having pioneered global investing more than 60 years ago, our perspective is built on decades of experience and shaped by the local expertise of our investment professionals who are on the ground across the globe, working to spot smart investment ideas and potential risks firsthand.

Strength and Experience

Today, Franklin Templeton is a global leader in asset management serving individuals and institutions in over 150 countries.[1] Since our founding in 1947, we've stayed focused on putting clients first and delivering relevant investment solutions, strong long-term results and reliable, personal service that have helped us to become a trusted partner to millions of investors around the globe.

1. As of 12/31/13. Clients are represented by the total number of shareholder accounts.

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<GAIN FROM OUR PERSPECTIVE®>

At Franklin Templeton Investments, we're dedicated to one goal: delivering exceptional asset management for our clients. By bringing together multiple, world-class investment teams in a single firm, we're able to offer specialized expertise across styles and asset classes, all supported by the strength and resources of one of the world's largest asset managers. This has helped us to become a trusted partner to individual and institutional investors across the globe.

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