

THE ACTIVE MANAGEMENT DIFFERENCE



Brent S. Smith, CFA
Senior Vice President,
Chief Investment Officer
Franklin Templeton
Managed Investment Solutions
Co-Lead Portfolio Manager,
Quotential[®] Program



Stephen R. Lingard, CFA, MBA
Vice President,
Director of Research
Franklin Templeton
Managed Investment Solutions
Co-Lead Portfolio Manager,
Quotential[®] Program



Paul L. Vaillancourt, CFA
Senior Vice President,
Portfolio Manager,
Director of Portfolio Strategy
Franklin Templeton
Managed Investment Solutions

Quotential[®] Program Proactively Capitalizing on Market Opportunities

The last two years have tested the resolve of many investors, but signs of recovery are appearing. Investors that stand to benefit from evolving market opportunities understand two things: what contributed to the magnitude of the recent downturn and the potential benefit from a more hands-on approach to money management.

One of the key investment principles tested in the market downturn of 2008 was diversification. Portfolio values appeared to head in one direction — down. This happened because international correlations converged closer than ever, says Brent Smith, Chief Investment Officer, Franklin Templeton Managed Investment Solutions^{*} and Co-Lead Manager for the *Quotential* Program. “If you go back 18 years, the correlations between various markets were very low, so standard or less sophisticated methods of diversification worked extremely well,” says Smith. “But look at how close they have become since then, essentially becoming close to 1.0.”

In light of this convergence across world markets, a more robust diversification strategy is required. The overall shape of world economies and the composition of their stock markets need to be more closely analyzed and evaluated.

Looking at the correlations of various sectors in the MSCI World Index, healthcare and energy had a very low correlation against each other, as did materials and consumer staples. “But what’s more important,” says Smith, “is that various sectors perform differently in different economic environments. As you come out of a market downturn and recessionary conditions, you start to see the economy recover and financials tend to do well. As we get to a peak and start to see more of a growth profile, energy, materials — those sectors — do quite well. The issue is to identify what part of the economic cycle we are in and to overweight those sectors.”

“I think returns from the capital markets are going to be much more muted in the years ahead,” Smith says. “Portfolio managers have to be much more willing to tactically rebalance. It’s not good enough to pick a long-term strategic approach to a portfolio and then just rebalance to their long-term targets.” It comes down to knowing what to invest in and when.

Strategic Asset Allocation Plus a Tactical Advantage

Asset allocation is not a new approach to portfolio construction. Most managed solutions typically use a strategic model that continues to hold the same predetermined percentage of equity and fixed-income holdings regardless of market changes. These portfolios are automatically rebalanced to their strategic models. A tactical asset allocation overlay aims to make targeted changes among asset type within a risk-controlled strategic allocation framework to create an additional source of alpha.

The *Quotential* Program employs a proactive tactical asset allocation strategy together with strategic asset allocation, making it stand out among its competitors.

Quotential offers global diversification by asset class, market capitalization, investment style and geographic region; access to a rich and deep management pool; and active management through tactical asset allocation.

It’s this pioneering use of both strategic and tactical asset allocation — backed by teams dedicated to both macroeconomic and fund research — that uniquely positions the managers to take advantage of market opportunities as they arise — ones that other portfolio managers often aren’t able to access.

The *Quotential* Investment Process

STEP #1 THE GLOBAL ASSET ALLOCATION COMMITTEE
It all starts with the firm’s global asset allocation committee, a group of investment professionals located worldwide. “We meet monthly to review key investment and financial indicators, data points, themes, trends, outlook and risks. Then we provide directions for asset mix in commodities, regions and currencies,” says Paul Vaillancourt, Senior Vice President, Portfolio Manager and Director of Portfolio Strategy for Franklin Templeton Managed Investment Solutions.

“It’s not good enough to pick a long-term strategic approach to a portfolio and then just rebalance to their long-term targets.”

It’s an integrated, global management team that takes the pulse of macroeconomic indicators and carefully monitors the performance of the firm’s fund managers worldwide.

Vaillancourt’s macroeconomic outlook is used to drive asset allocation decisions undertaken by Smith and the fund research undertaken by Stephen Lingard, Smith’s Co-Lead Manager and Vice President and Director of Research for the Managed Investment Solutions Group. The identification of key themes is used to provide tactical, cyclical and secular guidance for the proactive investment strategy that defines the team’s philosophy and process.

Regular portfolio strategy meetings encourage decision-making and real time refinements to selections and weightings. “In the portfolio strategy meeting we dive down deeply and assign weights to different portfolios,” explains Vaillancourt. Managers are expected to make ongoing tactical changes to a portfolio based on global economic shifts. Changes often occur monthly, but are permitted any time.

Tactical decisions are made under predetermined guidelines, for example, plus or minus 5% of the strategic asset mix is common, and can allow portfolio managers to emphasize asset classes displaying the most desirable risk/reward outlook. However, *Quotential* has an even greater flexibility — the ability to shift plus or minus 10% from the strategic asset allocation, without altering the strategic risk profile of the portfolio — that is unique in the managed solutions arena.

*Franklin Templeton Managed Investment Solutions (FTMIS) is a global team dedicated to global portfolio-based solutions, which draws on the expertise of a number of Franklin Templeton affiliates. In Canada, the advisor to the Canadian FTMIS mandates is Fiduciary Trust Company of Canada, which uses Templeton Investment Counsel, LLC as a subadvisor.

THE ACTIVE MANAGEMENT DIFFERENCE

STEP #2 MANDATE RESEARCH

Lingard's investment research analysts add value through security selection utilizing in-depth quantitative and qualitative analysis, portfolio optimization techniques and a disciplined due diligence and manager review process. Each analyst is responsible for a particular asset class. "We're able to get into a lot more detail with asset class specialists analyzing each of the funds and talking to the managers," says Lingard.

Lingard looks to Vaillancourt for recommendations on asset mix, currency, the growth/value split and sectors. Based on this intelligence they then pick good managers that may have slightly different views on a bottom-up basis and that will provide good out-performance versus the index and peers over a cycle.

"We may adjust the weightings on a monthly or quarterly basis if we see something that we really like and we think the market is positioned for this particular manager's style," explains Lingard.

Typically, three to four styles are held in each of four asset classes across 14 or 15 funds. The team analyzes the historical performance of the different mandates against their indexes to create portfolios with a low correlation in terms of mandates. The depth of Franklin Templeton's internal mandates includes top-performing funds from Templeton¹, Franklin, Bissett¹ and Mutual Series. Each investment management team offers unique style approaches and areas of expertise.

The *Quotential* investment team also has the flexibility to look externally to fill any gaps, which they took advantage of about a year ago. Bissett Investment Management is very strong in the growth at a reasonable price category, typically outperforming over full market cycles. But when the managers wanted to put an emphasis on growth mandates over the short-to mid-term, they turned to two third-party subadvisors for additional diversification benefits.

STEP #3 PORTFOLIO CONSTRUCTION

The result of this thorough analysis is a shifting set of responses to different sectors, styles, market caps and geographic exposures during the course of an economic cycle.

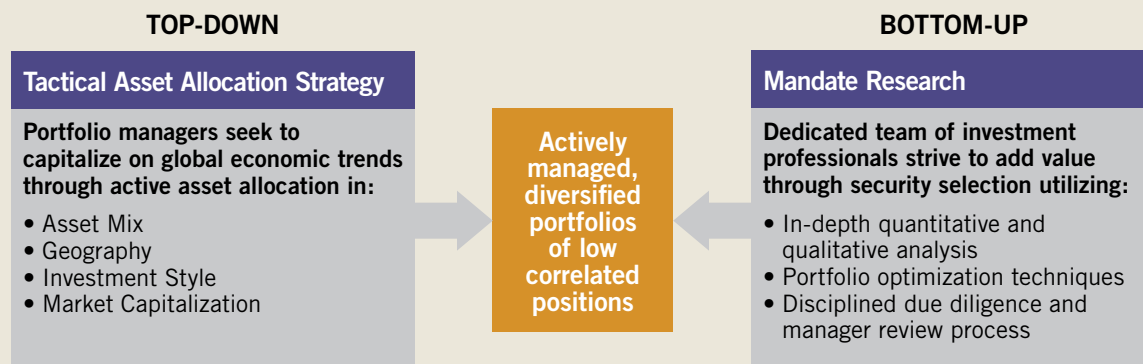
In addition to the global guidelines from the asset allocation committee and comprehensive fund research, the *Quotential* portfolio managers bring years of dedicated knowledge and experience to the investment process. Their expertise allows them to assess the optimal asset range set for each asset class and the target weightings and use their discretion to determine whether they want to deviate from these targets, by how much and through what means.

Combining the top-down macro assessment expertise of Vaillancourt and the bottom-up research expertise of Lingard, each portfolio is equipped with an asset mix befitting its objective and expectations of its investors. This is fairly impressive when one looks at the choice the *Quotential* program offers. With eight portfolio choices, *Quotential* covers the full spectrum from capital preservation to maximum growth.

It is this tactical overlay, conscious of each portfolio's varying objective and risk profile and employed throughout the investment process, that gives *Quotential* the edge over other managed solutions.

FRANKLIN TEMPLETON MANAGED INVESTMENT SOLUTIONS INVESTMENT PHILOSOPHY

- Multiple sources of expertise
- Investment philosophy and process driven from a high net worth and institutional perspective
- Two diversified sources of value-add to help deliver superior, risk-adjusted returns



STEP #4 TACTICAL ASSET ALLOCATION

As part of their ongoing active management, the managers conduct qualitative macroeconomic reviews to determine current investment themes and look at regional indicators in terms of liquidity, economic and financial indicators, growth and valuations.

"We believe that we're going to start to see the pickup in earnings going into the fall," says Smith. "We don't think that markets have necessarily factored in a recovery in earnings. There's a lot of money out there. So we think that's going to help corporate earnings growth, which affects equity markets. Equity markets are driven from earnings expectations, so we think eventually we're going to see earnings expectations and earnings growth drive forward."

In developing the tactical asset allocation strategies for the *Quotential* portfolios, the managers conduct performance attribution to identify and understand secular themes and cyclical trends affecting performance. Vaillancourt explains how this is seen with regards to emerging markets. "Our belief is that the world has changed a little bit and that already there's very strong industrial production out of the emerging market world and the emerging market consumer seems to be filling the gap," says Vaillancourt.

That view is reflected in Brent Smith's equity allocations for the *Quotential* portfolios. "We've increased exposure [to emerging markets] quite dramatically as a percentage of global equity exposure, from 14% in September 2008 to 45% recently," he notes.

Decisions to increase holdings in small caps, emerging markets and high-yield bonds lead to *Quotential's* outperformance for the six-month period ending August 31, 2009.[†]

"The days of buy, hold and forget about it are gone," Smith says "I don't think that you can just sit on your hands and say, 'over the long term, equities outperform.' Portfolio managers today have to be willing and able to be much more nimble in their asset allocation."

Nimble Options for Real Time, Active Investment Decisions

It's one thing to see market trends, Smith acknowledges, and quite another to implement them. To do that effectively, and fast, Franklin Templeton has adopted investment strategies that include using exchange

traded index funds (ETFs) to gain immediate exposure to a particular sector or region.

"Moving 5% of \$6 billion dollars (\$300 million) out of equities and into fixed income quickly can be impractical using conventional mutual funds," says Smith. However, using ETFs creates flexibility allowing managers to capitalize on opportunities through quick action on market changes.

Another useful tool is Franklin Templeton overseas funds domiciled in Luxembourg (SICAV funds), which provide access to a variety of markets and asset classes worldwide that are not immediately duplicable in Canada. As markets recover at different times and to different degrees, these SICAV funds will afford specific regional coverage, allowing more focused participation in identified evolving opportunities.

Together, these additional diversification options enhance nimbleness and let Franklin Templeton provide exposure to a larger variety of markets and asset classes.

"Some examples of mandates available through the SICAV platform are: an emerging market debt fund, an Asian market small-cap fund and an emerging-market small-cap fund." Instead, says Smith, by investing in ETFs and SICAVs the firm can quickly take advantage of changing market conditions in niche areas that can add value.

An additional strategy is currency management. "We're not going to go out and completely hedge foreign currency exposure back to Canadian dollars, because a lot of the benefit of international diversification is the result of currency moving in different directions," says Lingard. "We will use it incrementally to help manage our positions."

An ever-changing investment environment requires a hands-on, nimble strategy to ensure one is in the right place at the right time and properly positioned for both opportunities and challenges. As a large global firm, Franklin Templeton has the experience and expertise necessary for efficient, effective and ultimately, successful tactical asset allocation. And *Quotential's* proven, proactive investment process is capable of both growing and preserving its investment portfolios — through both optimistic and challenging markets.

For more information on *Quotential's* active management difference, visit www.activemanagement.ca.

The information presented herein is considered reliable at the present time, however, we do not represent that it is accurate or complete, or that it should be relied upon as such. Speculation or stated beliefs about future events, such as market and economic conditions, company or security performance, upcoming product offerings or other projections represent the beliefs of the author and do not necessarily represent the views of Franklin Templeton Investments Corp. General business, market, economic and political conditions could cause actual results to differ materially from what the author presently anticipates or projects. The information presented is not a recommendation or solicitation to buy or sell any securities.

[†]Source: Morningstar Research Inc. as of August 31, 2009.

1. Bissett Investment Management and Templeton Investment Management are operating divisions of Franklin Templeton Investments Corp.

