FRANKLIN TEMPLETON

Franklin Income Fund

Franklin Templeton Investment Funds

A (Mdis) USD
31 December 2020

Fund Commentary

Performance Review

- The optimism of many US investors backed strong fourth-quarter 2020 equity-market activity as they generally looked beyond the year's historic economic disruption to eventual signs of post-pandemic normalcy. As stocks soared on the longer-term prospects, the ongoing bull market broadened to include the most pandemic-challenged businesses. Instead of buying technology names that benefitted from people working and shopping from home (as was the clear trend from May through early September), many investors began to snap up cyclical companies and those that would recover from a reopened economy—particularly energy, financials, industrials and materials, which outperformed the gains across all seven other major equity sectors. Shares of smaller companies caught up with the blue chips as the year wore on and eventually eclipsed them. During the fourth quarter, small-capitalisation equities were the clear favorites as they substantially outperformed mid-caps and more than doubled the average return for large-caps. Additionally, the market finally rotated back into value stocks across all market-cap tiers after a prolonged period of outperformance by their growth-oriented counterparts. In fixed income markets, the 2020 rally in US Treasuries and government-sponsored credits faded as benchmark 10-year Treasury note yields increased from 0.69% to 0.93%, thereby weighing on prices to varying degrees. In corporate debt markets, the gains were broadly positive with investors generally netting larger price gains as they moved down the credit-quality spectrum from AAA to the lower end of the below-investment-grade segment (bonds rated BB+ and below). Some high-yield industry groups posted double-digit percentage returns including energy, airlines and aerospace.
- For the quarter, the fund's A (Mdis) USD shares returned 10.18%, and its benchmark, the Linked Blended 50% MSCI USA High Dividend Yield Index + 25% Bloomberg Barclays High Yield Very Liquid Index + 25% Bloomberg Barclays US Aggregate Index, returned 6.46%.

QUARTERLY KEY PERFORMANCE DRIVERS

	Equity Holdings	Equity Sectors	Fixed Income Holdings	Fixed Income Sectors/Industries
HELPED	JPMorgan Chase	Financials	Community Health Systems	Health Care
	Honeywell International	Energy	HighPoint Resources	Energy
	Morgan Stanley	Information Technology (IT)	Weatherford International	Consumer Discretionary
HURT	Intel	—	—	—
	AstraZeneca	—	—	—
	Dominion Energy	—	—	—

- Financials sector equities were amongst our strongest overall contributors to absolute returns throughout the autumn months. Top contributor JPMorgan Chase's (JPM's) equity value surged back towards its pre-pandemic levels, as did Bank of America, Morgan Stanley and all of the fund's other holdings in major global banks. JPM's latest earnings report beat analysts' consensus expectations on the top and bottom line—despite the hit to profit margins from low interest rates—as its investment banking operations surprised to the upside amidst heightened market volatility, including a 29% year-over-year increase in bond trading revenue. JPM also passed Federal Reserve and internal financial stress tests with flying colours and was able to reduce its ample loan-loss reserves as conditions improved from the pandemic worst-case scenario envisioned just six months ago.
- International benchmark crude oil prices rallied about 27% during the period as positive vaccine trial results indicated that life—and fuel consumption—might return toward normal in 2021, and so our energy equities and high yield corporate bonds rebounded in dramatic fashion on this potentially game-changing news. Like most energy holdings, integrated oil and gas conglomerate Chevron saw a sharp bounce in its stock off recent lows. We believe Chevron has continued to be well-positioned in the current environment given the company's combination of attractive assets, capital discipline, robust balance sheet and leverage to oil prices in a recovery. Management has continued to prioritise the dividend while maintaining asset integrity and long-term earnings power. According to our analysis, cost reductions of about US$1 billion are expected to be completed by year-end (with suggestions there could be more) and an additional US$300 million in synergies should be realised from Chevron's acquisition of Noble Energy in October.
- On the fixed income side of the portfolio, the contribution from our substantial investments in Community Health Systems (CHS) corporate bonds added more to absolute returns than the boost from our biggest equity contributor (JPM) and provided more than half of the overall fixed income gain. CHS, which operates acute care facilities, released a much stronger-than-expected third-quarter earnings report that detailed its rebound from first-half 2020 challenges stemming from the pandemic's severe business impacts. Additionally, the company applied the proceeds from asset sales towards debt reduction, and was able to access the debt and equity capital markets to meaningfully reduce their annual interest expense and extend the maturity profile of their capital structure.
- The fund's handful of equity detractors were minor overall and concentrated in the health care sector, where our positions in AstraZeneca (common stock) and Gilead Sciences (equity-linked note, or ELN) suffered modest declines. Elsewhere, Intel's negative-outlier status in the IT sector owed partially to mixed financial results that were nonetheless in line with expectations as work-from-home and cloud-service provider spending buoyed the semiconductor giant's top line. However, manufacturing challenges persisted, with no easy or imminent fix. Intel's mis-execution and increased competition hurt its profit margins, and the company's fourth-quarter guidance disappointed at a time when most semiconductor companies were beating consensus and raising their near-term outlooks. Among fixed income investments, there were no significant detractors, though our holdings in US Treasury notes, along with GNMA and FNMA mortgage-backed securities, failed to advance amidst rising interest rates.

ONE-MONTH KEY PERFORMANCE DRIVERS

	Equity Holdings	Equity Sectors	Fixed Income Holdings	Fixed Income Sectors/Industries
HELPED	JPMorgan Chase	Financials	Community Health Systems	Health Care
	Broadcom	IT	Weatherford International	Energy
	Rio Tinto	Materials	Calumet Specialty Products	Consumer Discretionary
HURT	Chevron	—	Occidental Petroleum	—
	Dominion Energy	—	—	—
	Verizon Communications	—	—	—

- Nine out of 11 equity sector allocations helped absolute returns in December (while consumer discretionary and communication services equities declined very slightly), as did all nine of the fund's corporate bond sector exposures. All financials equities continued to trend up in December, as did most energy equities as the global energy supply/demand balance further improved, while IT equities such as Broadcom and Analog Devices (both of which are involved with semiconductor manufacturing) staged a comeback following two months of mediocre returns versus other types of stocks.
- Chevron, which offered a healthy dividend yield of nearly 6% in late 2020, was an energy outlier to the downside as investors began to see the resurgent COVID-19 pandemic as a near-term negative for demand, while the firm's downstream earnings have been pressured by lower refining margins. Chevron has been reducing its operating and capital expenditures in response to market demand, and we see it as having the strongest balance sheet amongst its top industry peers.
- Rising oil and natural prices have greatly improved the debt and risk profiles of energy companies such as Weatherford International (oilfield services), which helped lead our broad-based gains across corporate bond holdings.
- Power companies were standout contributors in October and November, but they struggled to advance in December amidst mixed returns at the individual security level; investors tend to prefer utilities equities over other types of stocks during the market's risk-off phases, which certainly was not the case in December. On the fixed income side, there were no detractors of consequence.

Outlook & Strategy

- **Market View:** The effect of continued ample liquidity in the form of monetary and fiscal policy support, which is likely to continue to be provided across developed economies, has enabled many markets to shrug off the severe economic shocks inflicted by the COVID-19 pandemic. This has particularly been the case across fixed income sectors where benchmark US Treasury yields remain well below pre-pandemic levels and the Federal Reserve (Fed) has committed to keeping rates lower for longer. As a result, we think the appeal of many fixed income sectors has diminished as the potential for attractive total returns has become more challenged. We also recognise that the extraordinary experience of 2020 created tremendous divergence within global equity markets, and that the sectors and companies that led the recovery may not be the leaders in 2021. While vaccine development and distribution offer hope for further recovery and normalisation ahead, the current coronavirus surge being experienced by so many reminds us that significant risks remain.
- **Equities:** Expectations of an eventual recovery from the pandemic have become well-established in financial markets and increasingly reflected in equity valuations, while ongoing governmental support and central bank liquidity has continued to bode well for the asset class in 2021. We also think equity opportunities in early 2021 may favor sectors that were distinct laggards in 2020, including financials and utilities. Specifically, we believe valuations in consumer discretionary and communication services have been attractive relative to technology and other high-flying sectors of the past year. However, uneven control of the coronavirus has left the US and global economies far below their potential and pre-pandemic output. Efforts to return to economic normality have been slow and patchy amid the growing realisation that localised COVID-19 flare-ups will remain an ongoing threat, at least until a vaccine becomes widely available. US and global equities require a more convincing, sustained economic recovery to support elevated valuations despite the revival of corporate earnings since mid-2020. We believed the equity recovery would be uneven since the very start of the pandemic, and we continue to be selective in our investment process as the path forward remains extraordinarily uncertain.
- **Dividends:** In terms of dividend-paying equities, the cash crunch from pandemic-induced demand destruction added to corporate stress for many companies, making their dividends vulnerable, though the predicted magnitude of 2020 dividend fallout was proven to be somewhat overblown by year-end. For those companies that suspended their dividends in 2020, the highest rates of dividend interruption occurred in the consumer discretionary and energy sectors, but to a lesser extent they were also elevated in the financials and industrials sectors, both in the US and globally. However, dividend stocks appear to have recently resumed payouts after a pandemic pause that served as a quick way to preserve capital amidst business uncertainty. The narrative has changed and the overall payouts for 2020 are set to be only slightly smaller than in 2019, a major improvement from the levels forecast just six months ago. In particular, the information technology and health care sectors have shown recent dividend strength in the portfolio and we believe they continue to offer solid dividend-growth prospects.
- **Treasuries:** The Fed has adopted a new flexible inflation targeting regime and is likely to hold interest rates close to zero for an extended period of time. The Fed also remains biased to provide more stimulus as needed and maintain a stable US Treasury yield curve as it moves beyond the crisis-response phase. Stretched Treasury security valuations and supply dynamics slightly outweigh our economic growth concerns and subdued inflation expectations, and so we hold a marginally cautious position in the Treasury sector. The fund's holdings in short-term Treasury notes were meaningfully reduced in the latter half of 2020 before being completely eliminated in December.
- **Corporate Bonds (Overall):** An inconsistent global recovery and a bias towards easier monetary policy contrast with long-term fixed income valuations that remain expensive, in our view. Corporate bonds, having benefitted directly from central bank support, generally show signs of no longer providing adequate compensation for the credit risk they contain. This challenging backdrop still presents us with bond-buying opportunities as the asset class remains attractive to us on a more selective basis, in part because corporate debt can provide diversification and additional yield on top of that offered by similar maturity government bonds.

- **Investment-Grade Bonds:** The investment-grade sector has benefitted from robust Fed support, which has calmed markets significantly. Supportive corporate liquidity typically offsets high leverage and the risk of default. Yield spreads have narrowed as the market has focused on central bank buying. Renewed widening may occur if the recovery slows, but valuations remain supportive in a global context. As such, we maintain a broadly neutral view. We have been modestly reducing this allocation where valuations appeared stretched due to the influence of monetary policy interventions.
- **High-Yield Bonds:** By the end of 2020, all-in yields for US-based, below-investment-grade corporate credits had dropped to 4.18%—well below pre-pandemic levels-according to Bloomberg Barclays index data (while their spreads over Treasuries of 360 basis points (bps) were narrowing back towards February 2020 levels of 340 bps). The persistent impacts of the pandemic-induced recession are likely to continue weighing on the fundamentals for lower-rated fixed income sectors such as high yield despite the recent rebound in GDP. Default rates have been above historical averages, but the outlook is improving and in the longer term we retain a somewhat more constructive view on this market, balanced by caution over valuations that we think understate near-term fundamental uncertainties. As a result, we maintain a tactical preference away from the riskier end of the credit-risk spectrum. Longer term, we have adopted a somewhat more constructive view on the higher-quality end of the high-yield market, tempered by caution over near-term fundamental uncertainties within some industries such as retailers and other consumer-facing segments.

Fund Details

Inception Date	01/07/1999
Benchmark	Linked Blended 50% MSCI USA High Dividend Yield Index + 25% Bloomberg Barclays High Yield Very Liquid Index + 25% Bloomberg Barclays US Aggregate Index, Blended 50% MSCI USA High Dividend Yield Index + 25% Bloomberg Barclays High Yield Very Liquid Index + 25% Bloomberg Barclays US Aggregate Index

Fund Description

The fund aims to maximise income while maintaining prospects for capital appreciation by investing primarily in equity securities and long- and short-term debt securities. The fund may invest up to 25% of its net assets in non-US securities.

Performance Data[a]

Performance Net of Management Fees as at 31/12/2020 (Dividends Reinvested) (%)[b]

	1 Mth	3 Mths	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs	Since Inception
A (Mdis) USD	2.31	10.18	1.26	1.26	2.25	5.60	4.29	5.18
Net of Sales Charge - A (Mdis) USD	-2.80	4.67	-3.80	-3.80	0.51	4.52	3.75	4.93
A (Mdis) SGD-H1	2.27	10.07	0.32	0.32	1.38	4.92	3.90	2.70
Net of Sales Charge - A (Mdis) SGD-H1	-2.84	4.56	-4.70	-4.70	-0.33	3.85	3.37	2.31
Linked Blended 50% MSCI USA High Dividend Yield Index + 25% Bloomberg Barclays High Yield Very Liquid Index + 25% Bloomberg Barclays US Aggregate Index USD	1.59	6.46	4.64	4.64	6.47	7.81	7.91	5.74
Linked Blended 50% MSCI USA High Dividend Yield Index + 25% Bloomberg Barclays High Yield Very Liquid Index + 25% Bloomberg Barclays US Aggregate Index SGD	1.59	6.46	4.64	4.64	6.47	7.81	7.91	6.39

The Inception Date for the A (Mdis) USD share class and A (Mdis) SGD-H1 share class is 01/07/1999 and 25/10/2007.

Investment Team

Edward D. Perks, CFA
Years with Firm 28
Years Experience 28

Brendan Circle, CFA
Years with Firm 6
Years Experience 10

Todd Brighton, CFA
Years with Firm 20
Years Experience 20

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What Are the Key Risks?

The value of shares in the Fund and income received from it can go down as well as up and investors may not get back the full amount invested. Performance may also be affected by currency fluctuations. Currency fluctuations may affect the value of overseas investments. The Fund invests mainly in a diversified portfolio of U.S. equity, equity-related and debt securities. Such securities have historically been subject to price movements that may occur suddenly due to equity market- and bond market-specific factors. As a result, the performance of the Fund can fluctuate over time. The Fund may distribute income gross of expenses. Whilst this might allow more income to be distributed, it may also have the effect of reducing capital. Other significant risks include: credit risk, foreign currency risk. For full details of all of the risks applicable to this Fund, please refer to the "Risk Considerations" section of the Fund in the current prospectus of Franklin Templeton Investment Funds.

Important Legal Information

Franklin Income Fund is a sub-fund of the Luxembourg-domiciled Franklin Templeton Investment Funds (FTIF).

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Investors may wish to seek advice from a financial adviser before making a commitment to invest in shares of the Fund. In the event an investor chooses not to seek advice from a financial adviser, he/she should consider whether the Fund is suitable for him/her.

Issued by Templeton Asset Management Ltd. Registration No. (UEN) 199205211E

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a. Effective 1 February 2019, the Fund's benchmark is Linked Blended 50% MSCI USA High Dividend Yield Index + 25% Bloomberg Barclays High Yield Very Liquid Index + 25% Bloomberg Barclays US Aggregate Index. The benchmark performance shown is derived from a combination of the Custom 50% S&P 500 + 50% Bloomberg Barclays US Aggregate Index from the fund's inception to 31 January 2019 and the Blended 50% MSCI USA High Dividend Yield Index + 25% Bloomberg Barclays High Yield Very Liquid Index + 25% Bloomberg Barclays US Aggregate Index from 1 February 2019 to current reporting period.
b. Source for all information is Franklin Templeton Investments. Benchmark related data provided by FactSet. Fund performance computed in share class currency, on NAV-NAV basis and dividends reinvested. Net of Sales Charge figures are after 5% sales charge. Past performance is no guarantee of future results. Portfolio holdings are subject to change. Periods greater than one year are shown as average annual total returns. Other commissions, taxes and other relevant costs paid by investor are not included.

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