FRANKLIN TEMPLETON INVESTMENTS

Franklin U.S. Government Fund–A (Mdis) USD

Investment Grade Fixed Income
31 December 2018

Franklin Templeton Investment Funds

Fund Manager Report

Product Details[1]

Fund Assets	$650,202,374.44
Fund Inception Date	28/02/1991
Number of Securities Including Cash	1573
Bloomberg	TEMUSGI LX
ISIN	LU0029872446
Base Currency	USD
Investment Style	Investment Grade
Benchmark	Bloomberg Barclays US Government - Intermediate Index
Morningstar Category™	USD Government Bond

Asset Allocation[2]

Percent of Total

	%
Fixed Income	96.64
Cash & Cash Equivalents	3.36

Overall Morningstar Rating™ [3]

★★★

Fund Description

The Fund's investment objective is income and safety of principal. The Fund seeks to achieve its objective by investing in debt obligations issued or guaranteed by the U.S. government and its agencies, including purchasing mortgage- and asset-backed securities.

Performance Data

Performance Net of Management Fees as at 31/12/2018 (Dividends Reinvested) (%)[4]

	1 Mth	3 Mths	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs	Since Inception (28/02/1991)
A (Mdis) USD	1.09	1.11	-0.27	-0.27	0.05	0.80	1.87	3.62
Net of Sales Charge - A (Mdis) USD	-3.97	-3.95	-5.26	-5.26	-1.65	-0.22	1.35	3.43
Bloomberg Barclays US Government - Intermediate Index USD	1.49	2.22	1.43	1.43	1.20	1.46	1.83	4.83

Cumulative Performance (%)

	1 Mth	3 Mths	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs	Since Inception (28/02/1991)
A (Mdis) USD	1.09	1.11	-0.27	-0.27	0.15	4.09	20.38	168.89
Net of Sales Charge - A (Mdis) USD	-3.97	-3.95	-5.26	-5.26	-4.86	-1.12	14.36	155.45
Bloomberg Barclays US Government - Intermediate Index USD	1.49	2.22	1.43	1.43	3.66	7.53	19.90	271.75

Portfolio Manager Insight

Performance Review

QUARTERLY KEY PERFORMANCE DRIVERS

HELPED	Our allocations to GNMA I, namely higher coupon 4.0% through 6.0% securities, were major contributors to relative performance.
	Our allocations to GNMA II 5.5% and 6.0% coupons also benefitted returns.
	—
HURT	Our allocations to GNMA II, primarily 3.0% and 4.0% coupon securities, were major detractors from fund performance.
	Security selection in GNMA I 5.0%, 5.5% and 6.0% coupon securities hindered fund results.
	Security selection in GNMA II 3.5%, 5.5% and 6.0% coupon securities also detracted from fund performance.

1. All holdings are subject to change.

ONE-MONTH KEY PERFORMANCE DRIVERS

HELPED	Our allocations to GNMA I, primarily 4.0%, 5.0% and 5.5% coupon securities, were major contributors to relative performance.
	Our allocations to GNMA II 5.5% and 6.0% coupon securities also benefitted returns.
	—
HURT	Our allocations to GNMA II 3.0% and 4.0% coupon securities were major detractors from fund performance.
	Security selection in GNMA I 5.0%, 5.5% and 6.0% coupon securities hindered fund results.
	Security selection in GNMA II 3.5%, 5.5% and 6.0% coupon securities also detracted from fund performance.

Outlook Strategy

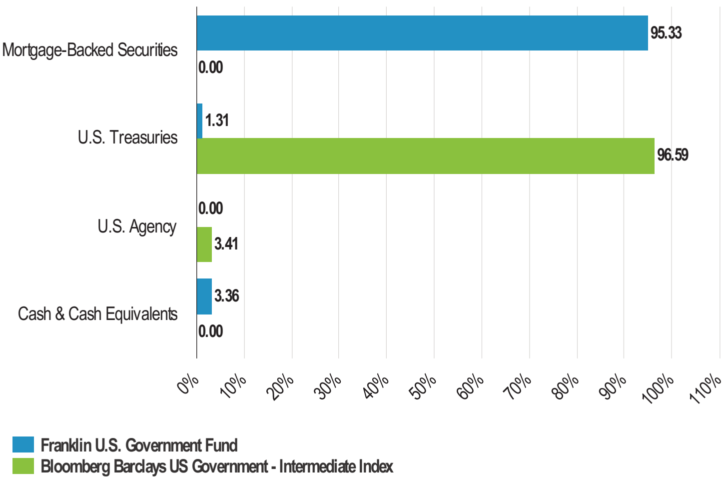
- At period-end, we remained more heavily weighted in GNMA II securities (comprised of multiple-issuer pools) versus GNMA I securities (comprised of single-issuer pools). The fund's largest absolute allocation remains in 3.5% coupon securities. The fund's largest underweight allocation relative to the index is in 3.0% coupon securities.
- MBS fundamentals remain supportive and the prepayment outlook continues to look fairly benign, in our view. The extended period of low mortgage rates led to a compressed coupon stack within the mortgage universe. In the current rising mortgage rate environment, there is less economic incentive to refinance, and many qualified homeowners who could refinance have already done so, leaving only approximately 10% of the existing universe eligible to refinance. With this fundamental backdrop, technical factors such as day count have a more meaningful impact on prepayment speed fluctuations on a monthly basis. However, we expect prepayments to remain contained, given the low incentive to refinance loans, increasing mortgage rates and slowing seasonal home purchases.
- As part of the balance sheet normalisation plan, the US Federal Reserve (Fed) should continue to maintain a US$20 billion cap on runoff during the first quarter of 2019 (Q1). Considering the current composition of the Fed's portfolio, the runoff on the portfolio should be less than US$20 billion a month, leading to investments of US$300 million a month for operational readiness purposes. We expect MBS spreads to widen during Q1 due to technical reasons, driven by an increase in supply as a result of reduced purchases from the Fed's balance sheet normalisation plan as mentioned previously.

Portfolio Characteristics[2]

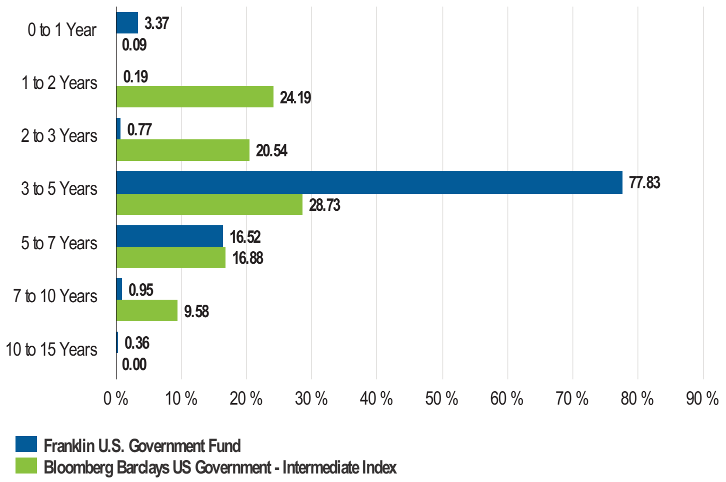
	Portfolio	Bloomberg Barclays US Government - Intermediate Index
Yield to Maturity	3.43%	2.54%
Yield to Worst	3.43%	2.54%
Average Duration	4.43 Yrs	3.75 Yrs
Average Credit Quality[5]	AAA	AA+
Average Weighted Maturity	6.11 Yrs	4.04 Yrs

Portfolio Diversification[2]

Sector Weightings vs. Bloomberg Barclays US Government - Intermediate Index
Percent of Total



Duration Breakdown vs. Bloomberg Barclays US Government - Intermediate Index
Percent of Total



5. The average credit quality (ACQ) rating may change over time. The portfolio itself has not been rated by an independent rating agency. The letter rating, which may be based on bond ratings from different agencies, is provided to indicate the average credit rating of the portfolio's underlying bonds and generally ranges from AAA (highest) to D (lowest). The ACQ is determined by assigning a sequential integer to all credit ratings AAA to D, taking a simple, asset-weighted average of debt holdings by market value and rounding to the nearest rating. The risk of default increases as a bond's rating decreases, so the ACQ provided is not a statistical measurement of the portfolio's default risk because a simple, weighted average does not measure the increasing level of risk from lower rated bonds. The ACQ is provided for informational purposes only. Derivatives are excluded from this breakdown.

Supplemental Performance Statistics

Supplemental Risk Statistics[6]

	3 Yrs	5 Yrs	10 Yrs	Since Inception
Standard Deviation (%)				
Franklin U.S. Government Fund	1.62	1.58	1.99	2.84
Bloomberg Barclays US Government - Intermediate Index	2.21	2.08	2.31	2.94
Tracking Error (%)	1.11	1.28	1.36	1.67
Information Ratio[7]	-1.04	-0.51	0.03	-0.73
Sharpe Ratio				
Franklin U.S. Government Fund	-0.60	0.11	0.76	0.35
Bloomberg Barclays US Government - Intermediate Index	0.08	0.40	0.64	0.75

Investment Team

Portfolio Manager	Years with Firm	Years Experience
Roger Bayston, CFA, SVP / Director, Investment Grade Fixed Income	27	33
Paul Varunok, SVP / Head of Mortgage Portfolio Management	17	27

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 debt securities issued or guaranteed by the U.S. government and its agencies. Such securities have historically proven to present some stability over time and have benefitted from a limited exposure to interest rates or movements in the bond market. As a result, the performance of the Fund can fluctuate to a small degree over time. Other significant risks include: liquidity 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.

6. Information Ratio and Tracking Error information are displayed for the product versus the Bloomberg Barclays US Government - Intermediate Index.

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The indices include a greater number of securities than those held in the Fund.

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7. Information Ratio is a way to evaluate a manager's ability to outperform a benchmark in relation to the risk that manager is assuming, with risk defined as deviation from the benchmark. This measure is calculated by dividing the portfolio's excess return (portfolio return less the benchmark return) by the tracking error (derived by taking the standard deviation of the monthly differences between the portfolio return and the benchmark return over time).

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