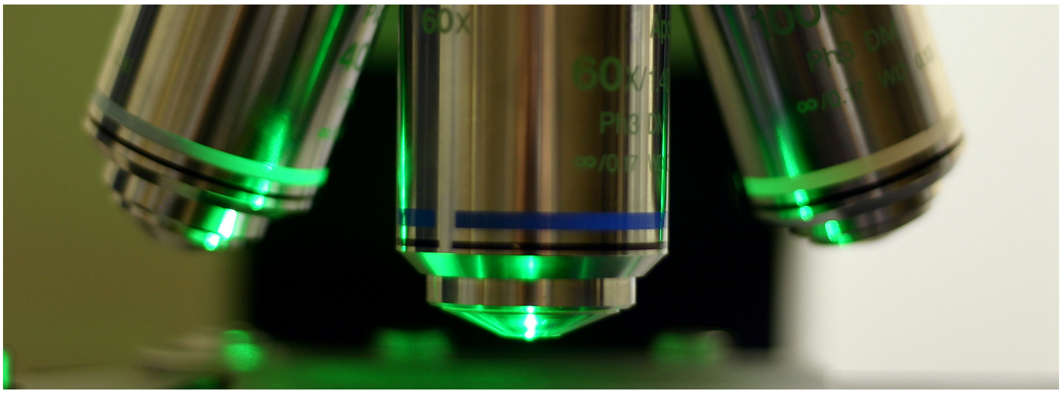
Perspective from
Franklin Templeton Global Index Portfolio Management Team



SINGLE-COUNTRY ALLOCATION: VIEWING THE OPPORTUNITY THROUGH THREE LENSES

March 2021

In our last paper, "The Post-Pandemic Case For International Markets," we highlighted some key reasons why we believed the case for investing in international equities remained strong in the face of a pandemic: lower valuations vs. the United States, divergent handling of the COVID-19 crisis among countries and depreciation of the US dollar after the rapid appreciation at the onset of the pandemic. We saw these investment opportunities come to fruition in 2020, where, as shown below, the broad market index returns were quite similar, between 15.38% and 16.64% for emerging and developed markets respectively, but single-country performance varied widely.

DISPERSION OF SINGLE COUNTRY PERFORMANCE

Exhibit 1: Developed and emerging market returns by country in USD

As of December 31, 2020

	2020 one-year returns (%)	Weight in FTSE All World Index (%)
FTSE All World Index	16.59	
FTSE Developed Market Index	16.64	
Top developed countries		
South Korea	47.24	1.78
Denmark	45.68	0.67
Netherlands	31.39	1.05
Sweden	28.18	0.94
Finland	24.04	0.32
Portugal	23.78	0.05
United States	20.78	55.64
New Zealand	20.47	0.10
Japan	14.63	7.41
Switzerland	13.14	2.60

	2020 one-year returns (%)	Weight in FTSE All World Index (%)
FTSE Emerging Markets Index	15.38	
Top emerging countries		
Taiwan	40.95	1.74
China	31.01	5.13
India	17.36	1.26
Malaysia	6.61	0.24
Saudi Arabia	4.36	0.35
Qatar	0.33	0.10
Philippines	(1.00)	0.11
Czech Republic	(1.25)	0.01
Mexico	(2.10)	0.24
UAE	(3.80)	0.09

Sources: FTSE, Bloomberg. Indexes are unmanaged, and one cannot invest directly in an index. They do not include fees, expenses or sales charges. **Past performance is not an indicator or guarantee of future performance.** Important data provider notices and terms available at www.franklintempletondatasources.com.

FRANKLIN TEMPLETON

The case for disaggregating international exposure by allocating to single countries (to realize excess performance relative to broad market indexes) remains strong, but the question is, how should investors move forward? With the interplay between the world's geopolitical, economic and social issues and the complexities of the pandemic and its ongoing recovery, it can be difficult to know where to start. Here are three lenses we think investors could consider:

LENS 1: PANDEMIC RECOVERY: BACK TO (THE NEW) NORMAL

As discussed, the spread of COVID-19 has had a lasting impact on individuals, companies and countries alike. As signs of a recovery begin to emerge, such as the approval and early distribution of multiple vaccines, so will new challenges and opportunities. We expect that this will, once again, create dispersion in how quickly countries are able to go "back to (the new) normal." Three such examples are outlined below.

Vaccine rollout

Globally, vaccine approvals are providing a much needed "light at the end the tunnel," helping both consumers and business envision a return to normal. However, early vaccine rollout is testing each country's ability to not only source, but effectively distribute and allocate among the population. It is apparent that not all countries will benefit equally as the logistical complexities and how well each country manages to vaccinate its citizens may create further dispersion in when/how each economy will recover. In some countries, this may include first having to convince the population of the benefits of vaccination. Among countries that have more buy-in, those with a more organized approach to the pandemic may also be the ones better positioned for the post-pandemic economic recovery. For example, Taiwan and South Korea have both been a model for handling the pandemic well through systematic and centralized approaches while demonstrating vigilance for continuous enhancements.

Economic impact

The post-pandemic recovery is expected to create a surge in the demand for both intermediate and end goods for consumers and businesses alike. Without proper planning, this can create shortages across certain industry segments and supply chains, such as raw materials, commodities, equipment, labor, etc. These shortages could potentially hold back the speed of economic recovery.

For example, as highlighted below, an increased demand for semiconductor chips from the consumer electronics and auto industries has created a shortage within the semiconductor chip industry.

The Semiconductor Industry Association (SIA) announced in February that global semiconductor industry sales were US$440.4 billion in 2020, an increase of 6.8% compared to the 2019 total of US$412.3 billion. This 6.8% increase is above the 5.1% initially projected, driven by a very strong fourth quarter 2020.[1] For 2021, World Semiconductor Trade Statistics projected that the global semiconductor market would grow 8.4% in 2021.[2]

The semiconductor manufacturing industry is complex and concentrated, with a high barrier to entry, so the stakes to maintain a technological competitive advantage are critical. The leading companies in this industry are in Taiwan and South Korea, while their US counterparts are not only losing market share but also their technological edge.

Commodities

Extremely low interest rates could be with us for a while as governments around the world struggle from the debt burdens caused by the COVID-19 crisis. Central banks have reduced policy rates to record lows and many developed countries have negative rates far out in their yield curves. Maintaining low interest rates for an extended period could lead to inflation, which may lead to opportunities in commodities due to a potential shortage of materials and equipment to meet increasing demand.

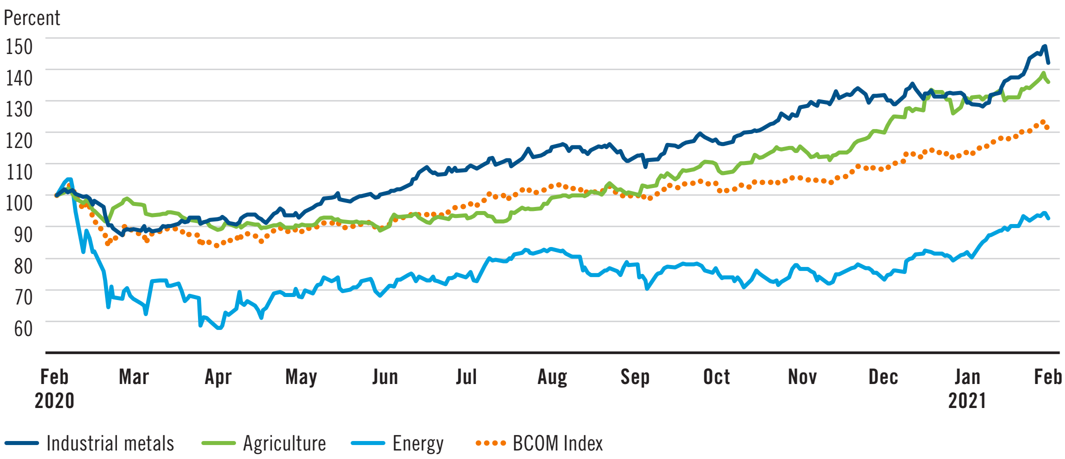
As a sign of continuing global economic recovery, the Bloomberg Commodities Index (BCOM) reached historic levels in February 2021, led by energy sectors year to date and industrial metals for the trailing one-year period.[3]

When commodity prices rise such as energy, the entire sector of oil and gas stands to benefit. The same holds true with a rise in industrial metals and basic materials, etc. Exhibit 3 highlights industry exposure for each country, as measured by ICB standards. Countries with exposure to these sectors may be well-suited to capitalize on continued global price appreciation. Speculation about inflation and economic recovery post-COVID-19 put commodities at the center of portfolio construction conversation.

COMMODITY LEVELS ON THE RISE

Exhibit 2: One-year relative return of commodity sectors

As of February 26, 2021

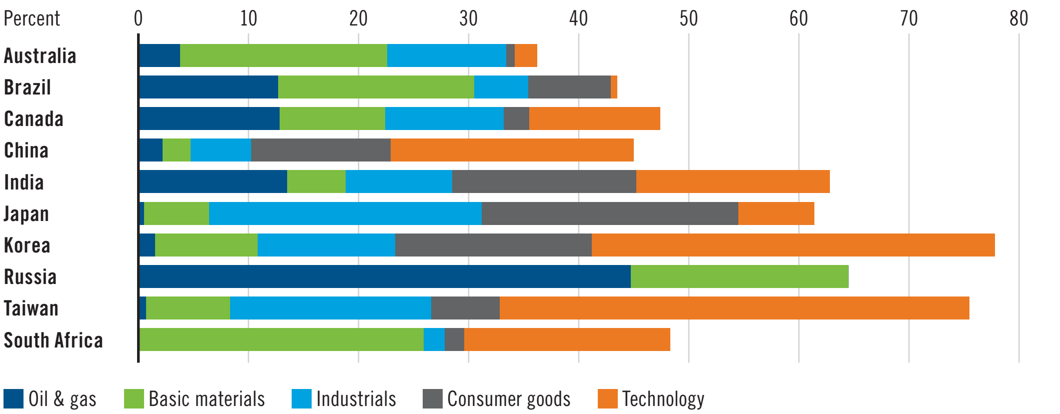


Source: Bloomberg. Note: Return levels are rebased/normalized to 100% for easy, relative comparison. Subsectors within the Bloomberg Commodities Index (BCOM) shown. Indexes are unmanaged, and one cannot invest directly in an index. They do not include fees, expenses or sales charges. **Past performance is not an indicator or guarantee of future performance.** Important data provider notices and terms available at www.franklintempletondatasources.com.

SELECT CYCLICAL INDUSTRIES ACROSS COUNTRIES

Exhibit 3: Industry exposure by country

As of December 2020



Source: FTSE. Industry classifications by ICB standards, and the single country indexes provided are the FTSE (Country) RIC Capped Index. Indexes are unmanaged, and one cannot invest directly in an index. They do not include fees, expenses or sales charges. **Past performance is not an indicator or guarantee of future performance.** Important data provider notices and terms available at www.franklintempletondatasources.com.

LENS 2: CHANGING GEOPOLITICAL LANDSCAPE

As they say, the only constant in life is change. This holds true, especially when it comes to geopolitical issues. In the US, after unprecedented legal challenges following last year's presidential election, the new administration is ushering in new policies in order to reshape the economy and improve foreign relations, especially in China where tensions have been running high due to friction over trade tariffs and technology. In Europe, we consider the four-year long Brexit saga and how it will impact UK trade policies across the continent. Moving further East, the new Asia-Pac trade agreement is paving the way for improved free trade among countries in that region.

Transfer of power in the United States

The start of President Biden's first term has been full of drama, not to mention several inherited issues that require quick attention, such as foreign and trade policies, climate issues and the pandemic.

President Biden and his administration came into office with an ambitious agenda and immediate plans to rollback the outgoing administration's executive orders including rejoining the Paris Climate Agreement, revoking the Keystone XL pipeline permit, and tightening climate regulations. In an effort to jumpstart an ailing domestic economy, Biden recently signed a massive COVID-19 stimulus package. And before a worldwide audience, he declared that "America is back," signaling his intent to restore the country's moral and diplomatic leadership. In addition, the new administration signaled that it would reengage with international partners in an effort to repair and rebuild alliances. However, Biden might not necessarily ditch all of the prior administration's ideas.

The Biden administration issued the "Made in America" executive order in January, which appoints a new "Made in America" director in the Office of Management and Budget, increases domestic supply requirements, encourages sourcing from small- and medium-sized US suppliers, and increases supervision of the current "Buy America" waiver program.[4] Federal contracting accounts for nearly US$600 billion in spending.[5] Sectors most likely to benefit domestically are information technology, industrials and health care. It's hard to estimate what global impact, if any, this will have on competing non-domestic suppliers.

US China rivalry escalates

The fight for world dominance between the United States and China is escalating, and it will likely take a greater focus for the Biden administration to handle the strained relationship in the coming years. China has been steadily increasing its influence via supporting infrastructure developments in Asia and Africa, and more recently leveraging the pandemic as a way to assert leadership by helping out other countries with COVID-19 management and vaccine distribution. Southeast Asia has emerged as a key battleground for influence between the United States and China amid an increasingly heated rivalry that extends across geopolitics, commerce and technology.

ASIA-PAC trade agreement[6]

On November 15, 2020, 15 countries in the Asia Pacific region signed the Regional Comprehensive Economic Partnership (RCEP), representing the largest trading bloc in the world, and one-third of the global output (US$26 trillion), or 30% of the world's population. This pact includes the 10 Southeast Asian Nations as well as Japan, China, South Korea, Australia and New Zealand. RCEP was nine years in the making and signifies a geopolitical win for China, especially with the United States notably missing. It is also the first free trade agreement among China, Japan and South Korea, which together account for about 24% of the world's economy and a combined yearly trading volume of over US$720 billion. Japan stands to benefit from its biggest trading partners China and South Korea as RCEP removes tariffs on approximately 90% of Japan's export to these countries. The trade volume between the three countries could increase considerably as a result and support the case of shortening supply chain by making trades with countries that are geographically closer even easier.

LENS 3: STRUCTURAL CHANGE

Structural changes are shifts that are still in the early innings and have a more enduring impact on the economy. These could range from changes in consumer behaviors (more online, shifting spending allocation), business models (subscriptions, data center to cloud, streaming), to changes in policy allocation of resources or incentives. Below are several structural changes in today's global economy that are driven by policy and investment as it relates to innovation and climate change.

Innovation[7]

We live in a rapidly changing world and as we've witnessed amid the pandemic, it is becoming more important to not only solve known problems, but be able to anticipate future challenges. The capacity to innovate measures how a country can adapt and mobilize its resources to solve emerging problems and has become a key indicator of future success—it is a combination of capabilities, readiness and flexibility to adapt resources and infrastructure to remove bottlenecks and find solutions. To measure this, Bloomberg created the Innovation Capacity Index, which ranks countries based on seven equally weighted metrics: research & development intensity, manufacturing value-added, productivity, high tech density, tertiary education efficiency, researcher concentration and patent activity.

- In 2021, South Korea ranked first in the Bloomberg Innovation Index, replacing Germany.
- In November 2020, South Korea ranked first in the Intellectual Capital Index.[8]

Climate change

Another structural change that should not be ignored is climate change, which is becoming ever more important for both short- and long-term investment horizons. The Earth's climate is now changing faster than at any point in the history of modern civilization. All around the world, we have seen more extreme weather and a greater frequency and magnitude of natural disasters. Climate affects nearly all aspects of our lives, from food sources, water supply to transport infrastructure, impacting both sectors and countries. The recent snowstorm in Texas showed how the mastering of supply chain to adapt to changing supply/demand created winners and losers. An Australian bank that controlled 80% of gas pipelines was able to allocate more supply to locations where the price for gas surged, creating a huge windfall, while the energy plants that are buying at the inflated prices—and consumers—are the losers. Each country's policies and actions around climate change could be a source of differentiation in a country's performance.

- Climate Change Performance Index: India in the top 10; United States at the bottom (#61).[9]
- Biden's climate plan may help to improve the US ranking significantly, but implementation of the plan beyond signing an executive order remains to be seen.

There are many things to consider when deciding where to invest among the constantly shifting, noisy markets. Disaggregating international exposure can help further refine risk and return objectives, while adding the flexibility to tailor allocations for specific outcomes. High return dispersion among countries and varying factors driving country performance make the case for the importance of country allocation, in our view, and single-country exchange-traded funds (ETFs) are cost-effective tools investors can use to gain precise exposure based on their convictions. Regardless of the lenses used to analyze and determine asset allocation, single-country ETFs empower investors to express views on what they consider may have the most material impact on returns.

CONTRIBUTOR

Dina Ting, CFA
Head of Global Index Portfolio Management Team
Franklin Templeton ETFs

With support from members of the Global Index Portfolio Management Team

Endnotes

1. Source: Semiconductor Industry Association, March 2021. "Global Semiconductor Sales Increase 6.5% to $439 billion in 2020."
2. Source: WSTS, December 2020. "WSTS Semiconductor Market Forecast Autumn 2020." There is no assurance any estimate, forecast or projection will be realized.
3. Source: Bloomberg, February 2021. "Commodities Hit Highest Since 2013 Amid Inflation Concern."
4. Source: Whitehouse Briefing, January 25, 2021. "Executive Order on Ensuring the Future Is Made in All of America by All of America's Workers."
5. Ibid.
6. Source: *The Straits Times*, December 2019. "China, Japan, South Korea to push for RCEP signing in 2020."
7. Source: Bloomberg, February 3, 2021. "South Korea Leads World in Innovation as U.S. Exits Top Ten"
8. Source: Solability, Sustainable Intelligence, November 2020. "Intellectual Capital Index Ranking 2020."
9. Source: CCPI, December 2020. Climate Change Performance Index 2021.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal. The value of investments can go down as well as up, and investors may not get back the full amount invested. Generally, those offering potential for higher returns are accompanied by a higher degree of risk. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. For actively managed ETFs, there is no guarantee that the manager's investment decisions will produce the desired results.

ETFs trade like stocks, fluctuate in market value and may trade above or below the ETF's net asset value. Brokerage commissions and ETF expenses will reduce returns. ETF shares may be bought or sold throughout the day at their market price on the exchange on which they are listed. However, there can be no guarantee that an active trading market for ETF shares will be developed or maintained or that their listing will continue or remain unchanged. While the shares of ETFs are tradable on secondary markets, they may not readily trade in all market conditions and may trade at significant discounts in periods of market stress.

Special risks are associated with foreign investing, including currency fluctuations, economic instability and political developments. Investments in developing markets, of which frontier markets are a subset, involve heightened risks related to the same factors, in addition to those associated with these markets' smaller size, lesser liquidity and lack of established legal, political, business and social frameworks to support securities markets. Because these frameworks are typically even less developed in frontier markets, as well as various factors including the increased potential for extreme price volatility, illiquidity, trade barriers and exchange controls, the risks associated with developing markets are magnified in frontier markets.

IMPORTANT LEGAL INFORMATION

This material is intended to be of general interest only and should not be construed as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy. It does not constitute legal or tax advice.

The views expressed are those of the investment manager and the comments, opinions and analyses are rendered as at publication date and may change without notice. The information provided in this material is not intended as a complete analysis of every material fact regarding any country, region or market. **All investments involve risks, including possible loss of principal.**

Data from third party sources may have been used in the preparation of this material and Franklin Templeton ("FT") has not independently verified, validated or audited such data. FT accepts no liability whatsoever for any loss arising from use of this information and reliance upon the comments opinions and analyses in the material is at the sole discretion of the user.

Products, services and information may not be available in all jurisdictions and are offered outside the U.S. by other FT affiliates and/or their distributors as local laws and regulation permits. Please consult your own financial professional or Franklin Templeton institutional contact for further information on availability of products and services in your jurisdiction.

Issued in the U.S. by Franklin Templeton Distributors, Inc., One Franklin Parkway, San Mateo, California 94403-1906, (800) DIAL BEN/342-5236, franklintempleton.com—Franklin Templeton Distributors, Inc. is the principal distributor of Franklin Templeton U.S. registered products, which are not FDIC insured; may lose value; and are not bank guaranteed and are available only in jurisdictions where an offer or solicitation of such products is permitted under applicable laws and regulation.

Australia: Issued by Franklin Templeton Investments Australia Limited (ABN 87 006 972 247) (Australian Financial Services License Holder No. 225328), Level 19, 101 Collins Street, Melbourne, Victoria, 3000 / **Austria/Germany:** Issued by Franklin Templeton Investment Services GmbH, Frankfurt, Mainzer Landstr. 16, 60325 Frankfurt/Main, Tel 08 00/0 73 80 01 (Germany), 08 00/29 59 11 (Austria), Fax +49(0)69/2 72 23-120, info@franklintempleton.de, info@franklintempleton.at / **Canada:** Issued by Franklin Templeton Investments Corp., 200 King Street West, Suite 1500 Toronto, ON, M5H3T4, Fax (416) 364-1163, (800) 387-0830, www.franklintempleton.ca / **Netherlands:** Franklin Templeton International Services S.à r.l., Dutch Branch, World Trade Center Amsterdam, H-Toren, 5e verdieping, Zuidplein 36, 1077 XV Amsterdam, Netherlands. Tel +31 (0) 20 575 2890 / **United Arab Emirates:** Issued by Franklin Templeton Investments (ME) Limited, authorized and regulated by the Dubai Financial Services Authority. Dubai office: Franklin Templeton, The Gate, East Wing, Level 2, Dubai International Financial Centre, P.O. Box 506613, Dubai, U.A.E., Tel +9714-4284100, Fax +9714-4284140 / **France:** Issued by Franklin Templeton International Services S.à r.l., French branch., 20 rue de la Paix, 75002 Paris France / **Hong Kong:** Issued by Franklin Templeton Investments (Asia) Limited, 17/F, Chater House, 8 Connaught Road Central, Hong Kong / **Italy:** Issued by Franklin Templeton International Services S.à.r.l.—Italian Branch, Corso Italia, 1—Milan, 20122, Italy / **Japan:** Issued by Franklin Templeton Investments Japan Limited / **Korea:** Issued by Franklin Templeton Investment Trust Management Co., Ltd., 3rd fl., CCMM Building, 12 Youido-Dong, Youngdungpo-Gu, Seoul, Korea 150-968 / **Luxembourg/Benelux:** Issued by Franklin Templeton International Services S.à r.l.—Supervised by the Commission de Surveillance du Secteur Financier–8A, rue Albert Borschette, L-1246 Luxembourg, Tel +352-46 66 67-1, Fax +352-46 66 76 / **Malaysia:** Issued by Franklin Templeton Asset Management (Malaysia) Sdn. Bhd. & Franklin Templeton GSC Asset Management Sdn. Bhd / **Poland:** Issued by Templeton Asset Management (Poland) TFI S.A.; Rondo ONZ 1; 00-124 Warsaw / **Romania:** Franklin Templeton International Services S.À R.L. Luxembourg, Bucharest Branch, at 78-80 Buzesti Str, Premium Point, 8th Floor, Bucharest 1, 011017, Romania. Registered with Romania Financial Supervisory Authority under no. PJM07.1AFIASMDLUX0037/10 March 2016 and authorized and regulated in Luxembourg by Commission de Surveillance du Secture Financiere. Telephone: + 40 21 200 9600 / **Singapore:** Issued by Templeton Asset Management Ltd. Registration No. (UEN) 199205211E. 7 Temasek Boulevard, #38-03 Suntec Tower One, 038987, Singapore / **Spain:** Issued by Franklin Templeton International Services S.à r.l.—Spanish Branch, Professional of the Financial Sector under the Supervision of CNMV, José Ortega y Gasset 29, Madrid, Spain. Tel +34 91 426 3600, Fax +34 91 577 1857 / **South Africa:** Issued by Franklin Templeton Investments SA (PTY) Ltd which is an authorised Financial Services Provider. Tel +27 (21) 831 7400, Fax +27 (21) 831 7422 / **Switzerland:** Issued by Franklin Templeton Switzerland Ltd, Stockerstrasse 38, CH-8002 Zurich / **UK:** Issued by Franklin Templeton Investment Management Limited (FTIML), registered office: Cannon Place, 78 Cannon Street, London EC4N 6HL, Tel +44 (0)20 7073 8500. Authorized and regulated in the United Kingdom by the Financial Conduct Authority / **Nordic regions:** Issued by Franklin Templeton International Services S.à r.l., Contact details: Franklin Templeton International Services S.à r.l., Swedish Branch, filial, Nybrokajen 5, SE-111 48, Stockholm, Sweden. Tel +46 (0)8 545 012 30, nordicinfo@franklintempleton.com, authorised in the Luxembourg by the Commission de Surveillance du Secteur Financier to conduct certain financial activities in Denmark, in Sweden, in Norway, in Iceland and in Finland. Franklin Templeton International Services S.à r.l., Swedish Branch, filial conducts activities under supervision of Finansinspektionen in Sweden / **Offshore Americas**: In the U.S., this publication is made available only to financial intermediaries by Templeton/Franklin Investment Services, 100 Fountain Parkway, St. Petersburg, Florida 33716. Tel (800) 239-3894 (USA Toll-Free), (877) 389-0076 (Canada Toll-Free), and Fax (727) 299-8736. Investments are not FDIC insured; may lose value; and are not bank guaranteed. Distribution outside the U.S. may be made by Templeton Global Advisors Limited or other sub-distributors, intermediaries, dealers or professional investors that have been engaged by Templeton Global Advisors Limited to distribute shares of Franklin Templeton funds in certain jurisdictions. This is not an offer to sell or a solicitation of an offer to purchase securities in any jurisdiction where it would be illegal to do so.

Please visit www.franklinresources.com to be directed to your local Franklin Templeton website.

CFA® and Chartered Financial Analyst® are trademarks owned by CFA Institute.

FRANKLIN TEMPLETON