FRANKLIN TEMPLETON

FREQUENTLY ASKED QUESTIONS

Franklin US Index

Why consider the Franklin US Index?

The Franklin US Index is designed to access the growth potential of US Equities, while managing financial risk (volatility) with a volatility target of 7% annually.

What exposure is the index designed to provide?

Long-term investment growth is historically optimized by an allocation to equity investments. Over the past 20 years, S&P 500 had average annual volatility of just over 17%. The Franklin US Index is designed to offer as much exposure to the US equity market as possible, without exceeding a volatility budget of 7% standard deviation[1] on an annualized basis. Similarly, in low volatility environments, the index is designed to increase its equity exposure (up to 150%) in order to use up the 7% volatility budget and to maximize growth opportunities.

What is the asset allocation mix for the index?

The index has an unconstrained asset allocation and no benchmark mix. It systematically uses four instruments to generate as much equity exposure as possible within the 7% volatility budget:

- Franklin Templeton's Smart Screen US Large cap index (FLQL1TR)
- S&P 10-Year Note Futures TR (SPUSTTTR)
- S&P 5-Year Note Futures TR (SPUST5TR)
- ICE Libor USD 3-Month (US0003M)

What is "Smart Screen" equity?

The equity "engine" of Franklin US Index is a smart beta equity index developed by Franklin Templeton and launched in 2016. It takes a list of 1000 well-recognized US large cap stocks and systematically measures those that demonstrate characteristics of investment Quality and Value—two systematic factors that our research shows are the most important contributors to stock performance. The index also looks at technical signals such as Momentum and Low Volatility, which can contribute to diversification. When the scores for each of these factors are added together, the top 250-scoring stocks are added to the index and those that fall below are removed. This rebalancing takes place semi-annually in June and December.

What is the anticipated average exposure to equity?

While the index rebalances its equity exposure daily, the backtests over 20 years show that the average allocation to equity was just under 58%. Forward-looking equity exposure is unknown as it will depend on market volatility, but will range between 0% and 150%.

How does the "MarketNav Technology" work?

MarketNav Technology has four main components that work in harmony on a day-to-day basis with the objective of meeting the 7% volatility target:

1. **A daily duration rule for fixed income index selection.** The index uses a systematic rule to determine which fixed income index to use. If rates are rising, the 5-year UST Index is selected. If rates are falling, the index switches to the 10-year UST Index. In the backtest period, this switch was made 32 times over 20 years.
2. **A daily allocation rule to determine the split between equity and fixed income.** If recent equity volatility is greater than 7%, the index uses a systematic rule to determine an increase in fixed income allocation. Similarly, if recent volatility is less than 7%, the mathematical formula determines a decrease in fixed income allocation.
3. **Short-term allocation to cash.** If the short-term volatility of the index is still greater than 7%, the index uses a systematic rule to reduce the allocation to both equity and fixed income in order to add cash.
4. **Short-term leverage into equity.** If the short-term volatility of the index is still below 7%, the index uses a systematic rule to add additional cash in order to increase the amount allocated to equity and fixed income.

It is not possible to invest directly in an index. There can be no assurance that any strategy will achieve its objectives.

1. A measure of the degree to which a strategy's return varies from the average of its previous returns. The larger the standard deviation, the greater the likelihood (and risk) that a strategy's performance will fluctuate from the average return.

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What was the historical max drawdown[2] for the index?

In the historical backtests, the max drawdown period was -10.7% (May 20, 2008 to October 15, 2008).

How often is cash used to reduce volatility?

How frequently the index will allocate to cash will depend on market volatility, but in historical backtests over the past 20 years, volatility was greater than 7% on 43% of days, during which the index allocated a portion of assets to cash in order to reduce volatility. The highest historical allocation to cash occurred during the period from October 2008 to April 2009 where the allocation to cash ranged daily between 30–50% of the portfolio. The second highest historical allocation to cash occurred in September 2016—at a time when fears around a potential rate hike by the Fed's peaked; during that time, the cash allocation was markedly increased.

How often is leverage used to boost volatility?

In the historical backtests over the past 20 years, volatility was lower than 7% on more than 65% of days. On these days, the index borrowed cash to increase exposure to equity and/or fixed income in order to increase the volatility to 7%.

Under what conditions might the index perform differently than the broader market?

The amount of equity exposure that the Franklin US index can take on is dictated by a systematic formula balancing estimates of equity risk with fixed income risk. Generally speaking, because equity is more volatile than fixed income, the index has lower equity exposure in periods where market volatility is high. Conversely, in periods where equity market volatility is low, the index can take on greater equity exposure.

- During periods of rapid decline and high equity market volatility—such as those experienced in 2001, 2002 and 2008—the Index exposure to equity was systematically reduced. In these conditions, the Franklin US Index outperformed the S&P 500.
- During periods of a broad market rally accompanied by high volatility—such as the 2009 recovery—the Franklin US Index would have reduced its exposure to equity in order to maintain its 7% volatility profile. In conditions such as this, the Franklin US Index underperformed the S&P 500.

Another lever that has a bearing on the index performance is yields. Because the Franklin US Index uses US Treasury Index (long or short duration) as one of its volatility levers, rising rates (and declining yields) can have a negative impact on index returns, particularly if it coincides with periods of high volatility in the equity markets. A good example of this scenario occurred in 2012 to 2013 when the 10-Year US Treasury increased from approximately 1.87% to 3.02% (1/1/2012 to 12/31/2013). In these conditions, the Franklin US Index had greater exposure to fixed income (due to high equity market volatility) and therefore had greater exposure to declining yields from fixed income. In these conditions, the Franklin US index underperformed the S&P 500, but still maintained its 7% volatility profile.

	TOTAL RETURN		AVERAGE WEIGHT (EXPOSURE)		
	Franklin US Index	S&P 500 Index	S&P 10-Year US Treasury Note Futures Total Return Index	S&P 5-Year US Treasury Note Futures Total Return Index	Smart Screen US Large Cap Index
2001	-3.02%	-13.68%	50.65%	0.93%	47.37%
2002	2.22%	-22.10%	47.06%	16.89%	46.97%
2003	15.04%	28.68%	39.29%	12.68%	59.77%
2004	10.58%	10.88%	13.76%	13.66%	70.61%
2005	1.04%	4.91%	15.60%	16.59%	66.58%
2006	5.92%	15.79%	5.95%	25.38%	66.15%
2007	7.47%	5.49%	37.64%	12.24%	60.25%
2008	-0.66%	-37.00%	66.72%	2.49%	34.48%
2009	6.56%	26.46%	24.47%	36.16%	29.92%
2010	13.70%	15.06%	41.51%	21.02%	53.06%
2011	11.14%	2.11%	46.00%	15.62%	55.48%
2012	6.69%	16.00%	50.38%	0.00%	64.68%
2013	18.50%	32.39%	3.00%	32.39%	64.07%
2014	8.21%	13.69%	19.61%	14.32%	70.78%
2015	-2.36%	1.38%	32.15%	17.92%	55.34%
2016	5.89%	11.96%	35.00%	8.25%	62.37%
2017	20.83%	21.83%	0.35%	3.04%	104.18%
2018	-2.44%	-4.38%	0.48%	42.27%	61.25%

Source: Bloomberg. The Franklin US Index is an excess return index. The index levels represent performance in excess of the 3-month US Dollar LIBOR rate. All information for the index prior to its launch date is back-tested, based on the methodology that was in effect on the launch date on November 13, 2017. Back-tested performance, which is hypothetical and not actual performance, is subject to inherent limitations because it reflects application of an index methodology and selection of index constituents in hindsight. No theoretical approach can take into account all of the factors in the markets in general and the impact of decisions that might have been made during the actual operation of an index. Actual returns may differ from, and be lower than back-tested returns. The performance data does not reflect the deduction of any fees/charges and assumes reinvestment of interest or dividends. There can be no assurance that implementation of managed volatility strategies will produce desired results. Hypothetical performance information is not indicative or a guarantee of future results. Please see full answer for greater detail on highlighted years in chart above.

2. Monthly compounded return, net of all fees and expenses, representing the largest 'peak to trough' loss sustained within a specified date range, including any temporary gains.

How often does the index rebalance?

Unlike market-cap weighted indexes which need to rebalance periodically to account for changes in market cap, the Franklin US Index is a systematic solution that rebalances daily[3] to blend the asset mix, in order to maintain the 7% volatility target.

Who is administering the index?

Franklin US Index is administered by Standard & Poor's.
http://www.customindices.spindices.com/indices/custom-indices/franklin-us-index

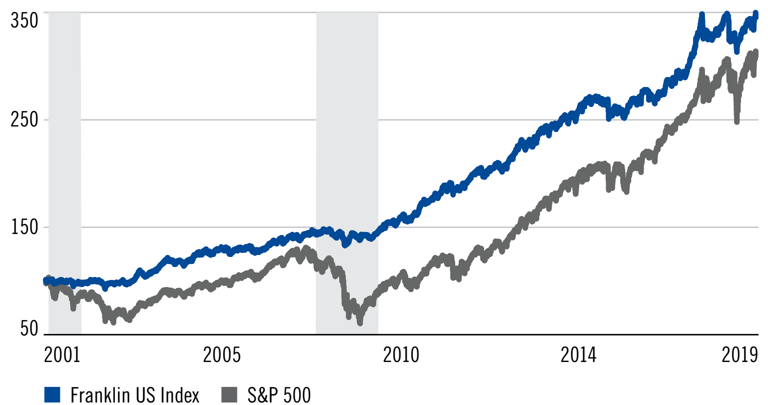
What are the key features of the Franklin US Index?

1. Smart-Screen Equity seeks to screen for the highest quality US stocks, providing an engine for growth.
2. MarketNav Technology aims to manage the fluctuation in capital during periods of market volatility.
3. By systematically managing volatility in an effort to limit drawdowns, the time-to-recovery may be shortened.

FRANKLIN US INDEX

Return Profile (cumulative return)

January 2001–June 2019



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3. Although the Franklin US Index rebalances daily, the underlying index rebalances quarterly.

NOTES ON PERFORMANCE CALCULATIONS

Performance information in this presentation is for illustrative purposes only and includes hypothetical, backtested returns. As such it does NOT represent or guarantee the performance of any Franklin portfolio, whose performance may vary significantly from that which is shown.

A target volatility is not total return performance—the investment manager does not expect, nor does it represent, that the strategy's total return performance would be any specific level or within any specified range or provide competitive returns. It is possible that the strategy could meet a target volatility level while having negative performance returns.

There can be no guarantee that the strategy will reduce volatility or achieve any specific level of volatility. The target volatility strategy may expose the portfolio to losses (some of which may be sudden) to which it would not otherwise have been exposed if it only invested directly in securities.

The actual volatility that the strategy experiences may be significantly higher or lower than that sought by the investment manager at any time and for any period of time. The use of derivative instruments in an effort to adjust exposures may at times increase volatility, for reasons including the economic leveraging effect of those instruments. In addition, the target volatility strategy could limit the fund's performance in rising markets and may expose the portfolio to costs to which it would otherwise not have been exposed.

The Franklin US Index (the "Index") is the property of Franklin Templeton, which has contracted with S&P Opco, LLC (a subsidiary of S&P Dow Jones Indices LLC) to calculate and maintain the Index. The Index is not sponsored by S&P Dow Jones Indices or its affiliates or its third party licensors (collectively, "S&P Dow Jones Indices"). S&P Dow Jones Indices will not be liable for any errors or omissions in calculating the Index. "Calculated by S&P Dow Jones Indices" and the related stylized mark(s) are service marks of S&P Dow Jones Indices and have been licensed for use by Franklin Templeton Investments. S&P® and the S&P 500 Index are registered trademarks of Standard & Poor's Financial Services LLC ("SPFS"), and Dow Jones® is a registered trademark of Dow Jones Trademark Holdings LLC ("Dow Jones"). Additional important data provider notices and terms available at www.franklintempletondatasources.com.

The hypothetical performance information presented herein does not reflect the results of actual trading and calculation of the index levels and performance do not reflect the fees and expenses that an investor would pay. These fees and expenses would cause the actual and back-tested performance of the index to be lower. For example, if an investor invested $100,000 in an investment product that returned 10% ($10,000 in gains) over a 12-month period and was charged an asset-based fee of 1.5% at the end of the period on the investment plus gains (a $1,650 fee), the investor's net return would be 8.35% ($8,350). Over three years, an annual 1.5% fee taken at the end of each year with the same assumed 10% return per year would result in a cumulative gross return of 33.10% but a net return (after $5,375 in fees) of 27.2%.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal.

Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. Bond prices generally move in the opposite direction of interest rates. Thus, as the prices of bonds in an investment portfolio adjust to a rise in interest rates, the value of the portfolio may decline. Special risks are associated with foreign investing, including currency fluctuations, economic instability and political developments. Investments in developing markets involve heightened risks related to the same factors, in addition to those associated with their relatively small size, lesser liquidity and lack of established legal, political, business, and social frameworks to support securities markets. Such investments could experience significant price volatility in any given year. Derivatives, including currency management strategies, involve costs and can create economic leverage in a portfolio, which may result in significant volatility and cause the portfolio to participate in losses (as well as enable gains) on an amount that exceeds the portfolio's initial investment.

Investing in the natural resources sector involves special risks, including increased susceptibility to adverse economic and regulatory developments affecting the sector—prices of such securities can be volatile, particularly over the short term. Some strategies, such as hedge fund and private equity strategies, are available only to pre-qualified investors, may be speculative and involve a high degree of risk. An investor could lose all or a substantial amount of his or her investment in such strategies. Real estate securities involve special risks, such as declines in the value of real estate and increased susceptibility to adverse economic or regulatory developments affecting the sector.

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