Franklin Flexible Alpha Bond Fund–A (acc) USD

FRANKLIN TEMPLETON

Multi-Sector Fixed Income
31 May 2020

Franklin Templeton Investment Funds

Fund Manager Report

Product Details[1]

Fund Assets	$177,415,732.21
Fund Inception Date	18/03/2016
Number of Securities Including Cash	295
Bloomberg	FTFAAAU LX
ISIN	LU1353034298
Base Currency	USD
Investment Style	Multi-Sector
Benchmark	LIBOR 90 Day (USD) Index
Morningstar Category™	Global Flexible Bond

Asset Allocation[2,3]

Market Value—Percent of Total

	%
Fixed Income	96.34
ASSET_MIX_FI_FIXED_INC	96.34
Cash & Cash Equivalents	3.66
ASSET_MIX_FI_CASH	3.66

Fund Description

The Fund seeks to provide total return through a combination of current income and capital appreciation by investing in a wide range of global debt securities in terms of country, sector, quality, maturity or duration without reference to a benchmark index. The Fund aims to provide attractive risk-adjusted total returns over a full market cycle.

Performance Data

Discrete Annual Performance (%) as at 31/05/2020

	5/19-5/20	5/18-5/19	5/17-5/18	5/16-5/17	5/15-5/16
A (acc) USD	-2.68	2.16	0.49	0.99	-
LIBOR 90 Day (USD) Index USD	1.68	2.54	1.71	0.97	0.48

Performance Net of Management Fees as at 31/05/2020 (Dividends Reinvested) (%)[4,5]

	1 Mth	3 Mths	YTD	1 Yr	3 Yrs	Since Inception (18/03/2016)
A (acc) USD	3.57	-4.42	-3.88	-2.68	-0.03	0.38
LIBOR 90 Day (USD) Index	0.03	0.20	0.46	1.68	1.98	1.67

Past performance is not an indicator or a guarantee of future performance.

Portfolio Manager Insight

Performance Review

ONE-MONTH KEY PERFORMANCE DRIVERS

	Currencies	Duration/Yield Curve	Sectors
HELPED	Indonesian Rupiah	United States	Residential Mortgage-Backed Securities (RMBS)
	Colombian Peso	South Africa	Collateralised Loan Obligations (CLOs)
	South African Rand	Colombia	Sovereign Emerging Market (EM) Bonds
HURT	Australian Dollar	Europe	—
	Euro	—	—
	Japanese Yen	—	—

- In May, sector allocations were the primary contributors to absolute performance. Exposures to RMBS, CLOs, and sovereign EM bonds lifted performance. Spread sectors continue to improve from the drastic widening experienced in March.
- Duration positioning contributed to performance during the month led by our exposure to US, South African, and Colombian duration. This was partially offset by our European duration positions.
- Our active currency positions detracted from performance. Short exposure to the Australian dollar and euro detracted from returns as did our long position in the Japanese yen. However, our long positions in the Indonesian rupiah, Colombian peso, and South African rand boosted results.

Outlook & Strategy

- To halt or at least slow the spread of the virus, a number of governments across the world have suddenly shut down large parts of their economies, causing an enormous degree of disruption in just a small amount of time. Governments and central banks immediately stepped in with powerful fiscal and monetary policy expansions; these will be very helpful in cushioning the short-term damage, but the recovery prospects hinge crucially on how quickly economic activity can resume. The priority must be to identify a strategy to restart global economic activity while maintaining appropriate precautions to safeguard public health, which will likely require widespread testing capacity, contact tracing, serology testing and some form of continued social distancing measures.

1. All holdings are subject to change.

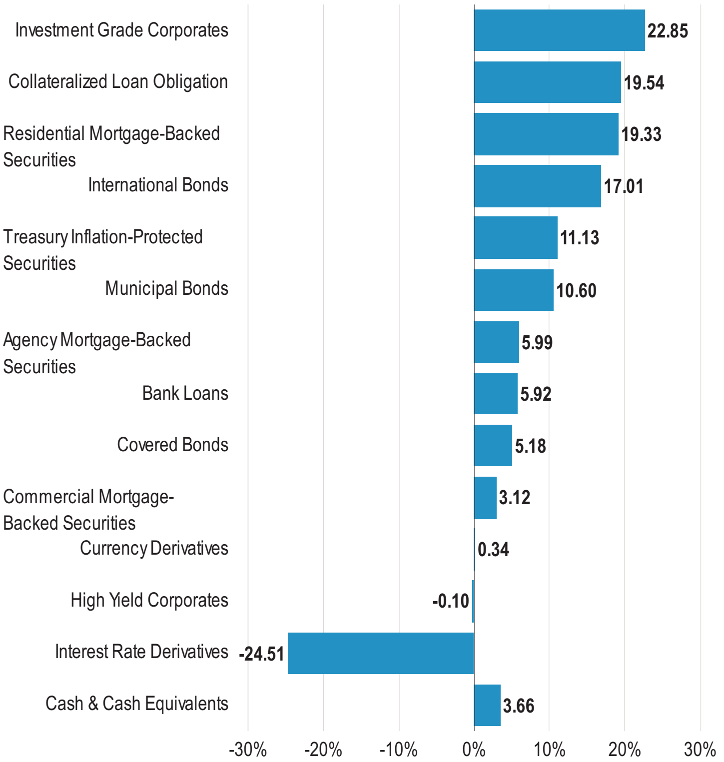
- We are currently tracking three different recovery scenarios in our outlook. The first scenario is essentially a counterfactual of the trajectory for growth and jobs without any fiscal stimulus. The second scenario assumes that there is a mild pass-through of the fiscal spending, while the third scenario assumes a significantly strong passthrough. We believe that the effectiveness of the fiscal transfer will be the main driver of the speed of the recovery starting towards the end of 2020 and into 2021. Under all three scenarios, the outlook for the second quarter (Q2) 2020 is broadly the same: the quarter-on-quarter (q/q) annualised growth rate for Q2 falls by between 29% and 30%. Overall, in all three scenarios, we do not expect the economy to reach its pre-crisis trend growth level by the end of next year. We believe the cost of the COVID-19 crisis to the euro area (EA) will be substantial, since not only have EA governments shut down large sections of their economies at the same time, but also because a large share of these economies are heavily reliant on the services sector (60%-70% of gross domestic product in EA countries), which has suffered the largest negative impact. Hence, we believe the economic damage done by this coronavirus-induced crisis is likely to prove substantial for the region and last for several quarters. We expect the lockdowns to sink the EA economy into deep recession in the first half of 2020, before a recovery in the second half of the year.
- We believe that the drop in inflation expectations currently priced into Treasury Inflation-Protected Securities (TIPS) exceeds our estimate for the impact this crisis will have on growth and inflation over the next five to 10 years and that BE levels are inconsistent with the fundamental backdrop. However, we see that breakeven (BE) rates have returned to a more normalised level and are not likely to increase significantly in the short-term due to additional US Federal Reserve (Fed) purchases and market sentiment but will remain range-bound at current levels, in our view.
- The global collapse in economic activity caused by COVID-19, coupled with the steep drop in oil prices, has drastically eroded corporate profits and driven volatility in the investment-grade (IG) credit market. IG corporate spreads have rebounded since the widest levels of late March, but still remain near recessionary levels. While the fundamental outlook is challenging, market technicals became more balanced in May. We feel IG corporate bonds will benefit from more attractive valuations and Fed support for the market, although valuations are now closer to near-term fair value given the high degree of uncertainty over the duration and severity of the crisis. We expect continued demand for IG corporates as a source of relatively safe yield. We believe the recent tightening in the high-yield market is overdone, and therefore we remain moderately bearish. Nothing precludes a widening from current spread levels, which in our view do not appropriately price in the expected sharp spike in defaults, nor the sizable wave of fallen angels that could lead to price dislocations.
- We continue to remain optimistic regarding the resilience of the CLO structure. The structural features of CLOs provide protection to investors in times of distress, particularly in the senior parts of the capital structure. We continue to believe senior IG tranches have enough subordination that the risk of principal loss remains remote. However, single-A and triple-B rated tranches will continue to face mark-to-market moves as well as potential downgrades (particularly at the triple-B level) as COVID-19 stresses continue. With minimal Fed support for the asset class, we favour higher-quality exposure at the top of the credit stack (triple- and double-A rated).
- Spreads on taxable municipal bonds (munis) continued to tighten over the month of May as market technicals improved in the broader muni bond market. Issuance in taxable munis continued at a brisk pace with several issuers replacing tax-exempt debt with new taxable issuance due to low all-in yields. The market remained extremely fractured. Price dislocations are resulting in attractive valuations in certain sectors with positive long-term prospects, while many other sectors face headwinds, including credits highly concentrated in tourism, oil and gas, transportation, retail sales, and governments with very high fixed costs (debt, pensions and retiree health care) and limited financial flexibility.
- The Fed's active participation in the MBS sector has been supportive of the asset class, and spreads have returned to a more normalised level, albeit still trading wider than pre-GFC levels. We believe Fed buying will continue, keeping spreads well-supported and range bound. In our view, the sector will continue to benefit from Fed purchases and represents a solid carry trade. Although our view is offset somewhat by elevated prepayment risk and relatively tight spreads.
- Since RMBS markets bottomed out in March, actual loss schedule credit risk transfer (CRT) bond prices have since recovered almost 70% and we expect to see further price appreciation as markets normalise. Fiscal and monetary stimulus measures, although not directly supporting the CRT markets, will also ease liquidity concerns in other sectors which should eventually benefit the liquidity of CRTs. The loans underlying these CRT transactions are of significantly higher quality—higher credit scores, lower debt-to-income (DTI), and lower loan-to-value (LTV) ratios—than the loans issued during the global financial crisis. We continue to favour seasoned vintages of CRTs, which offer defensive characteristics. Although we still expect non-agency RMBS to provide strong risk-adjusted returns, from a broader perspective the potential economic headwinds and generally supportive valuations balance each other out.
- The volatility of the COVID-19 pandemic has severely impacted CMBS. The sector received some stabilisation through the Fed's accommodation of triple-A CMBS for the Primary Dealer Credit Facility (PDCF) as well as inclusion of the asset class in the eligible securities for the Term Asset-Backed Securities Loan Facility (TALF). However, the Fed support only aids approximately 15% of the commercial real estate (CRE) market and a significant number of properties may come under considerable pressure without additional relief measures to blunt the impact. Issuance has started to pick up, with dealers offering deals with a much better collateral mix to entice investors to invest in new issue CMBS. In conjunction with the normalisation in broader credit markets, spreads have tightened across the stack. We believe downside risks outweigh upside potential, and we continued to favour the top of the capital structure.
- Our outlook on EM is that economies will begin to resume normal activity levels over the course of 2020. Risks around an extended economic drag due to additional waves of COVID-19 and resulting shutdowns and a failure for commodity markets to follow the path implied by futures markets are significant; therefore, we expect a difficult period in the short-term for EM debt. Without a buyer of last resort in EM credit, liquidity is also a factor with the potential to exaggerate changes in asset prices, as has been the case in recent months. However, looking beyond the near term, our positive outlook for EM debt remains largely intact as the temporary factors that have unsettled financial markets subside, supporting the compression of risk premia back to more normal levels.

Portfolio Characteristics[2,6,7,8]

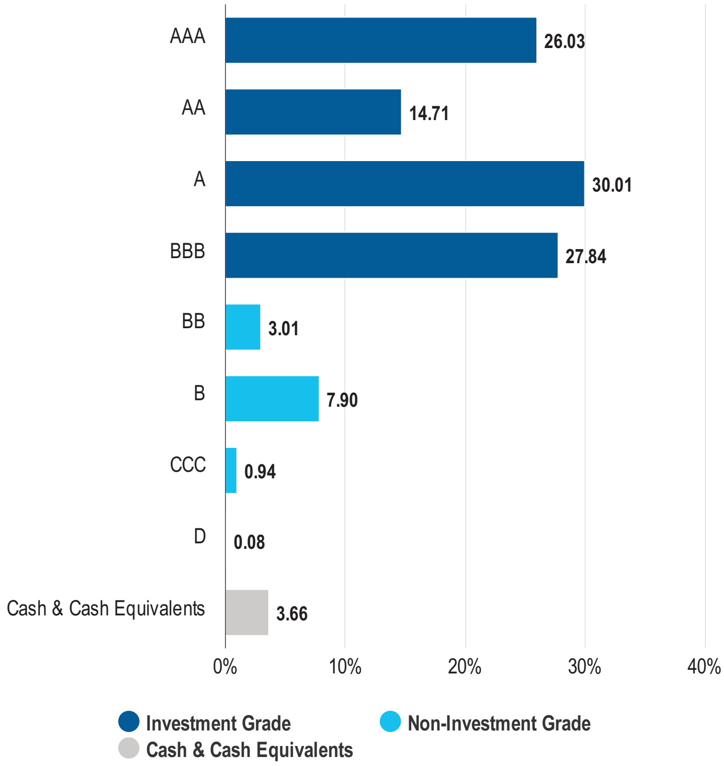
	Portfolio
Yield to Maturity	2.95%
Yield to Worst	2.94%
Average Duration	1.68 Yrs
Average Credit Quality[9]	A-
Average Weighted Maturity	4.64 Yrs

Portfolio Diversification[2]

Sector Exposure[10,11]
Notional Exposure—Percent of Total



Credit Quality Exposure[12,13]
Notional Exposure—Percent of Total



7. Average Credit Quality figures are intended to estimate the portfolio's exposure to issuer credit risk, including any hedged or increased exposure through credit derivatives held in the portfolio (or their underlying reference assets). Any credit derivatives are assigned the ratings of their underlying reference assets.
9. 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 (or internal ratings for unrated bonds, cash and equivalents), is provided to indicate the average credit rating of the portfolio's underlying investments and generally ranges from AAA (highest) to D (lowest). For unrated bonds, cash and equivalents, ratings may be assigned based on the ratings of the issuer, the ratings of the underlying holdings of a pooled investment vehicle, or other relevant factors. The ACQ is determined by assigning a sequential integer to all credit ratings AAA to D, taking a simple, asset-weighted average of investments 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 may be lower if cash and equivalents are excluded from the calculation. The ACQ is provided for informational purposes only.
12. Notional exposure figures are intended to estimate the portfolio's exposure to issuer credit risk, including any hedged or increased exposure through credit derivatives held in the portfolio (or their underlying reference assets). Any credit derivatives are assigned the ratings of their underlying reference assets. Portfolio breakdown percentages may not total 100% and may be negative due to rounding, use of any derivatives, unsettled trades or other factors.
13. Ratings shown are assigned by one or more Nationally Recognized Statistical Rating Organizations ('NRSRO'), such as Standard & Poor's, Moody's and Fitch. The ratings are an indication of an issuer's creditworthiness and typically range from AAA or Aaa (highest) to D (lowest). When ratings from all three agencies are available, the middle rating is used; when two are available, the lowest rating is used; and when only one is available, that rating is used. Foreign government bonds without a specific rating are assigned the country rating provided by an NRSRO, if available. The NR category consists of ratable securities that have not been rated by an NRSRO. The N/A category consists of nonratable securities (e.g., equities). Cash includes equivalents, which may be rated.

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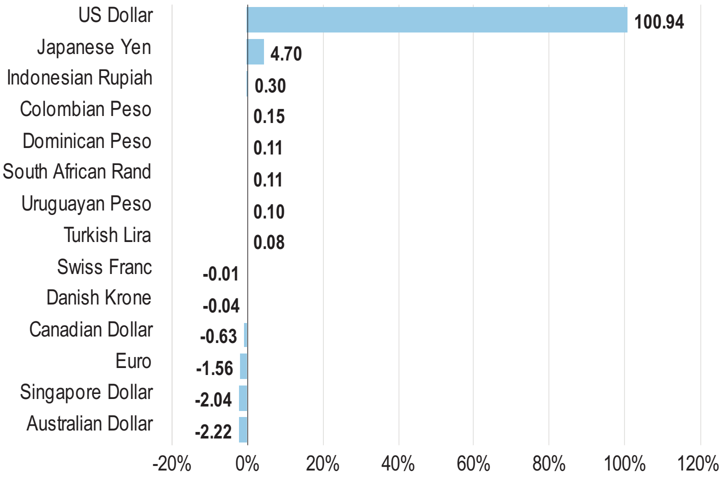
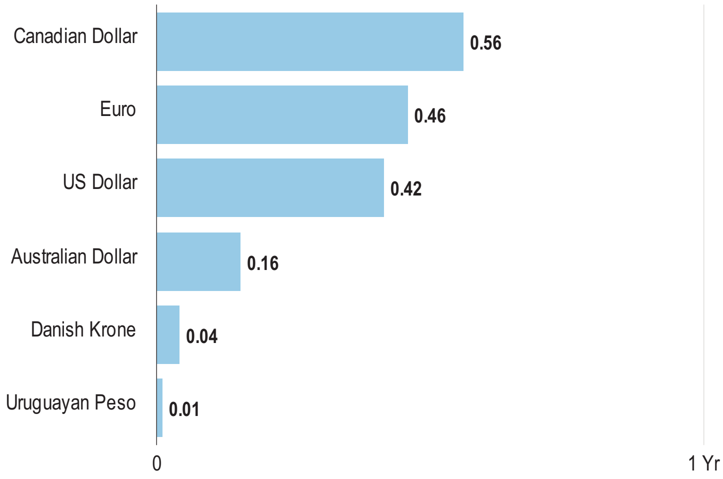
Currency Exposure[10]

Notional Exposure—Percent of Total



Duration Contribution by Currency[14]



Supplemental Performance Statistics

Supplemental Risk Statistics[15]

	3 Yrs	Since Inception
Standard Deviation (%)		
Franklin Flexible Alpha Bond Fund	6.40	5.45
LIBOR 90 Day (USD) Index	0.17	0.20
Tracking Error (%)	6.42	5.47
Information Ratio[16]	-0.31	-0.24
Sharpe Ratio		
Franklin Flexible Alpha Bond Fund	-0.27	-0.18
LIBOR 90 Day (USD) Index	1.85	1.85

Investment Team

Portfolio Manager	Years with Firm	Years Experience
David Yuen, CFA	24	32
Tina Chou	15	17
William Chong	11	11
Sonal Desai, Ph. D.	10	26

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 seeks to generate attractive risk-adjusted returns over a full market cycle by allocating its investments across a wide range of debt securities and debt obligations of any maturity or credit rating of corporate and/or sovereign issuers worldwide, with the ability to actively use financial derivative instruments. Such securities and investment instruments have historically been subject to price movements due to such factors as sudden changes in interest rates, changes in the financial outlook or perceived credit worthiness of securities issuers, or fluctuations in currency markets. As a result, the performance of the Fund can fluctuate to a small degree over time. Other significant risks include: counterparty risk, credit risk, currency risk, emerging markets risk, liquidity risk, operational 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.

15. Information Ratio and Tracking Error information are displayed for the product versus the LIBOR 90 Day (USD) Index.
16. 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).

Important Legal Information

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The information provided is not a complete analysis of every material fact regarding any country, market, industry, security or fund. Because market and economic conditions are subject to change, comments, opinions and analyses are rendered as of the date of this material and may change without notice. A portfolio manager's assessment of a particular security, investment or strategy is not intended as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy; it is intended only to provide insight into the fund's portfolio selection process. Holdings are subject to change.

Securities mentioned in this report are not a solicitation to purchase those securities, and are examples of some securities which performed well. Not all securities in the portfolio performed well. These securities do not represent all the securities purchased, sold or recommended for advisory clients, and the reader should not assume that investment in the security listed was or will be profitable. Holdings are subject to change, holdings of the same issuer have been combined. The information provided is not a recommendation to purchase, sell or hold any particular security. The security identified does not represent the Fund's entire holdings and in the aggregate, may represent a small percentage of such holdings. There is no assurance that security purchased will remain in the Fund, or that security sold will not be repurchased. In addition, it should not be assumed that any securities mentioned were or will prove to be profitable. For the most current information on the fund, please contact your Franklin Templeton marketing representative.

Performance figures are not based on audited financial statements and assume reinvestment of interest and dividends. When comparing the performance of Franklin Templeton Investment Funds (the "Fund") with a benchmark index, it is important to note that the securities in which the Fund invests may be substantially different than those represented by the benchmark index. Furthermore, an investment in Franklin Templeton Investment Funds represents an investment in a managed investment company in which certain charges and expenses, including management fees, are applicable. These charges and expenses are not applicable to indices. Lastly, please note that indices are unmanaged and are not available for direct investment. Certain data and other information shown have been supplied by outside sources. While we consider that information to be reliable, we give no assurance that such data and information is accurate or complete.

References to indexes are made for comparative purposes only and are provided to represent the investment environment existing during the time periods shown. The indices include a greater number of securities than those held in the Fund. An index is unmanaged and one cannot invest directly in an index. The performance of the index does not include the deduction of expenses and does not represent the performance of any Franklin Templeton fund. **Past performance is not an indicator or a guarantee of future performance.**

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2. Information is historical and may not reflect current or future portfolio characteristics. All holdings are subject to change.
3. Market value figures reflect the trading value of the investments. Portfolio breakdown percentages may not total 100% and may be negative due to rounding, use of any derivatives, unsettled trades or other factors.
4. Source for all information is Franklin Templeton. Benchmark related data provided by FactSet. **Past performance is not an indicator or a guarantee of future performance.** Periods greater than one year are shown as average annual total returns. Fund performance data include reinvested dividends, and is net of management fees. Sales charges, other commissions, taxes and other relevant costs to be paid by the investor are not included. The fund offers other share classes subject to different fees and expenses, which will affect their performance. Please see the prospectus for details.
5. When performance for either the portfolio or its benchmark has been converted, different foreign exchange closing rates may be used between the portfolio and its benchmark.
6. Yield to Maturity, Yield to Worst, Average Duration and Average Weighted Maturity reflect certain derivatives held in portfolio (or their underlying reference assets).
8. Yield figures quoted should not be used as an indication of the income that has or will be received. Yield figures are based on the portfolio's underlying holdings and do not represent a payout of the portfolio. **Past performance is not an indicator or a guarantee of future performance.**
10. Notional exposure figures are intended to estimate the portfolio's exposure, including any hedged or increased exposure through certain derivatives held in the portfolio (or their underlying reference assets). Portfolio breakdown percentages may not total 100% and may be negative due to rounding, use of any derivatives, unsettled trades or other factors.
11. Interest Rate Derivatives sector consists of Treasury, interest rate and other derivatives that are primarily used for duration management; a negative number indicates that we are seeking to hedge interest rate risk.
14. Figures reflect certain derivatives held in the portfolio (or their underlying reference assets).

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