EDISON

Templeton Emerging Markets Inv. Trust

Continuation of strategy under new lead manager

Investment trusts

19 June 2018

Templeton Emerging Markets Investment Trust (TEMIT) has been managed by Chetan Sehgal since the beginning of February 2018, when he took over from prior lead manager Carlos Hardenberg. The two managers had worked closely together for a number of years and there will be no change to the investment process. Sehgal will continue to follow Franklin Templeton's value-based, bottom-up stock selection approach, aiming to generate long-term capital growth. The manager is optimistic on the outlook for emerging market equities, citing above-average earnings growth with below-average valuations versus global equities. TEMIT has recently announced its FY18 results (ending 31 March); its NAV and share price total returns of 12.4% and 13.7% respectively were ahead of the 11.8% total return of the benchmark MSCI Emerging Markets index.

12 months ending	Share price (%)	NAV (%)	MSCI Emerging Markets (%)	MSCI World (%)	FTSE All-Share (%)
31/05/14	(8.2)	(8.9)	(5.4)	8.0	8.9
31/05/15	(1.1)	2.5	10.3	16.8	7.5
31/05/16	(16.2)	(14.4)	(13.3)	1.3	(6.3)
31/05/17	56.0	55.6	44.2	32.0	24.5
31/05/18	6.4	6.9	11.0	8.8	6.5

Source: Thomson Datastream. Note: All % on a total return basis in pounds sterling.

Investment strategy: Bottom-up stock selection

Lead manager Sehgal follows Franklin Templeton's value-based, five-step investment process: identification of undervalued companies; in-depth fundamental analysis; team peer review; portfolio construction; and portfolio evaluation and attribution analysis. The bottom-up approach means that TEMIT's portfolio can vary markedly from the benchmark in terms of sector and geographic allocations. Gearing of up to 10% of NAV is permitted (net gearing of 4.1% at end May 2018).

Market outlook: Relatively attractive growth and value

Forecast economic growth for emerging markets is higher than for developed economies – contributing factors include the rate of technological innovation, rising demand from increasing middle classes and rising commodity prices. While emerging market share prices can be more volatile than those in developed markets, their valuations are relatively attractive; as an example, the MSCI Emerging Market index is trading on a c 25% lower forward P/E multiple than the MSCI World index.

Valuation: Current discount wider than average

TEMIT is currently trading at a 13.6% discount to cum-income NAV. This is higher than the averages of the last one, three, five and 10 years (range of 9.6% to 12.8%). The board actively seeks to manage the discount by regularly buying back shares. During FY18, 3.4% of the share count was repurchased at a cost of c £70m. In FY18, TEMIT's 15p dividend was 82% higher than in FY17, which was helped by a reallocation of fees; its current dividend yield is 2.1%.

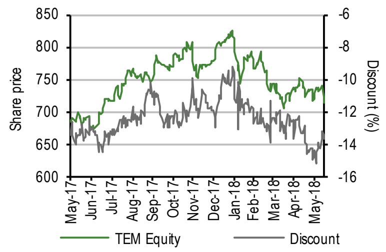
Price	**713.0p**
Market cap	**£1,897m**
AUM	**£2,268m**

NAV*	821.0p
Discount to NAV	13.2%
NAV**	825.5p
Discount to NAV	13.6%

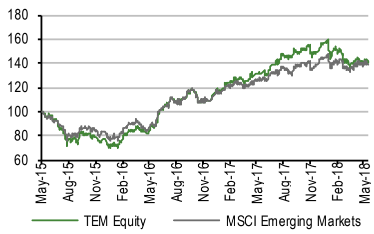
*Excluding income. **Including income. As at 15 June 2018.

Yield	2.1%
Ordinary shares in issue	266.1m
Code	TEM
Primary exchange	LSE
AIC sector	Global Emerging Markets
Benchmark	MSCI Emerging Markets

Share price/discount performance



Three-year performance vs index



52-week high/low	825.0p	673.0p
NAV** high/low	918.2p	774.8p

**Including income.

Gearing

Net*	4.1%

*As at 31 May 2018.

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Templeton Emerging Markets Inv. Trust is a research client of Edison Investment Research Limited

Exhibit 1: Trust at a glance

Investment objective and fund background

Launched in June 1989, TEMIT was one of the first emerging markets funds in the UK. The trust seeks long-term capital appreciation through investment in companies operating in emerging markets, or listed on the stock markets of such countries. This may include companies that have a significant amount of their revenues in emerging markets, but which are listed on stock exchanges in developed countries. Performance is benchmarked against the MSCI Emerging Markets Index.

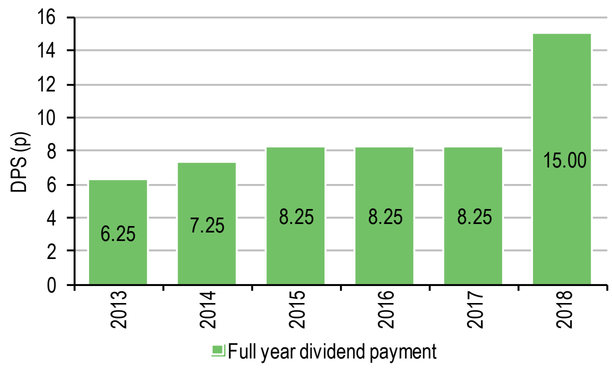
Recent developments

- 5 June 2018: Annual report to 31 March 2018. NAV TR +12.4% versus benchmark TR +11.8%. Share price TR +13.7%.
- 1 February 2018: Chetan Sehgal appointed as TEMIT's lead portfolio manager, following the resignation of Carlos Hardenberg.
- 31 January 2018: Portfolio manager Mark Mobius retired, after more than 30 years with Franklin Templeton.

Forthcoming		Capital structure		Fund details	
AGM	July 2018	Ongoing charges	1.12%	Group	Templeton Asset Management
Interim results	November 2018	Net gearing	2.9%	Manager	Chetan Sehgal
Year end	31 March	Annual mgmt fee	0.85-1.0% of net assets (see page 7)	Address	5 Morrison Street, Edinburgh, EH3 8BH, UK
Dividend paid	July and January	Performance fee	None		
Launch date	12 June 1989	Trust life	Indefinite (subject to vote)	Phone	+44 (0)871 384 2505
Continuation vote	Five yearly (last in 2014)	Loan facilities	£150m	Website	www.temit.co.uk

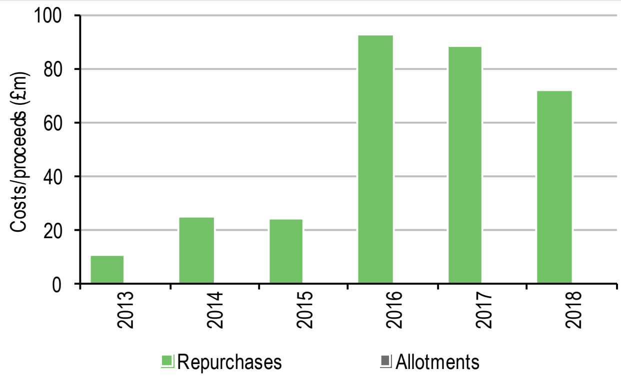
Dividend policy and history (financial years)

FY18 dividend was boosted by a change in fee allocations. Dividends were historically paid annually in July, but starting in FY19, will be paid twice a year in July and January.

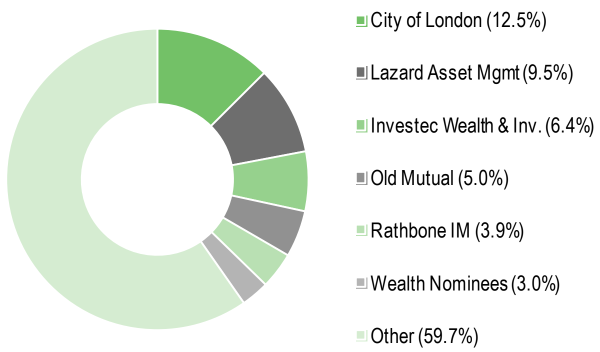


Share buyback policy and history (financial years)

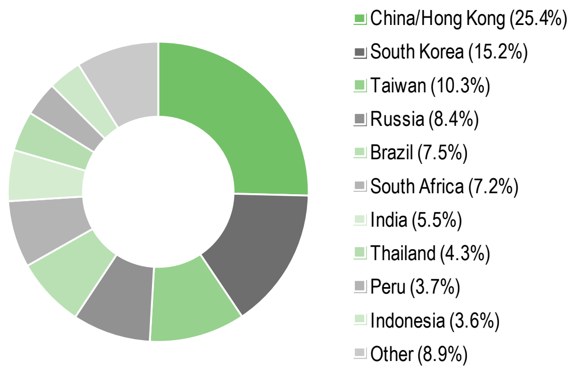
Renewed annually, TEMIT is authorised to repurchase up to 14.99% and allot up to 5% of its issued ordinary shares.



Shareholder base (as at 31 May 2018)



Portfolio exposure by geography (as at 31 May 2018)



Top 10 holdings (as at 31 May 2018)

			Portfolio weight %	
Company	**Country**	**Sector**	**31 May 2018**	**31 May 2017***
Samsung Electronics	South Korea	Information technology	8.5	7.0
Naspers	South Africa	Consumer discretionary	6.4	4.8
Alibaba (ADR)	China/Hong Kong	Information technology	5.1	2.9
Taiwan Semiconductor Manufacturing	Taiwan	Information technology	5.0	4.5
Brilliance China Automotive	China/Hong Kong	Consumer discretionary	4.8	7.3
Unilever	UK	Consumer staples	3.5	3.9
Tencent	China/Hong Kong	Information technology	3.4	3.8
Buenaventura (ADR)	Peru	Materials	3.4	2.9
ICICI Bank	India	Financials	2.4	N/A
LUKOIL (ADR)	Russia	Energy	2.2	N/A
Top 10			**44.7**	**42.9**

Source: Templeton Emerging Markets Investment Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in May 2017 top 10.

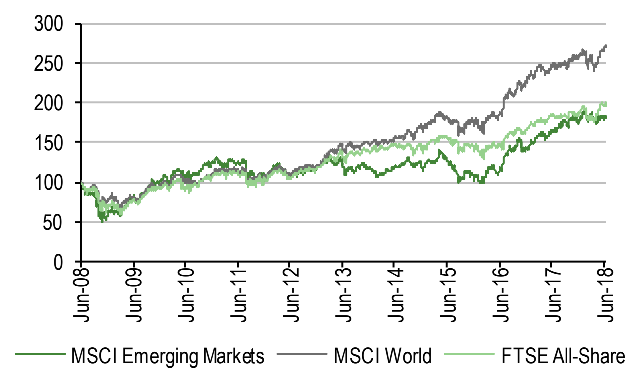
Market outlook: Higher growth and lower valuations

The performance of stocks, in sterling terms, over the last 10 years is shown in Exhibit 2 (LHS). Over the period, emerging market equities have performed broadly in line with the UK market, while both have lagged the world index that is dominated by US companies, which have performed particularly well. Economic growth prospects continue to favour emerging markets. In its April 2018 World Economic Outlook, the International Monetary Fund forecasts for emerging markets GDP growth were 4.9% and 5.1% in 2018 and 2019 respectively, which are meaningfully higher than 2.5% and 2.2% respectively for developed markets. Drivers for emerging market economic growth include the rising affluence of the middle classes and improving commodity prices.

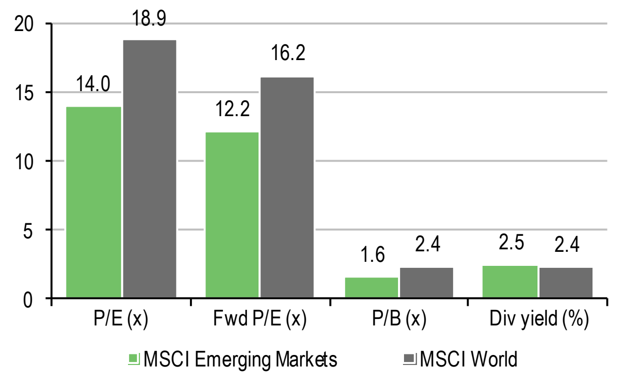
While emerging market equities can be more volatile than those in developed markets, one may argue that this risk is fully reflected in share price valuations. On a forward P/E multiple basis, the MSCI Emerging Markets index is trading at a c 25% discount to the MSCI World index. It is also trading on a lower price-to-book multiple, while offering a modestly higher dividend yield.

Exhibit 2: Market performance and valuation

Performance of indices in £ (last 10 years)



Valuation metrics (as at 15 June 2018)



Source: Thomson Datastream, Edison Investment Research, MSCI

Fund profile: Diversified emerging market equity fund

TEMIT was one of the first UK-listed funds investing in emerging markets and is the largest, with c £2.3bn assets under management. It was launched in June 1989 and is quoted on the London and New Zealand stock exchanges. On 1 February 2018, it was announced that lead manager Carlos Hardenberg, who succeeded Dr Mark Mobius on 1 October 2015, would be stepping down. He has been replaced by TEMIT's former deputy manager Chetan Sehgal, who had worked closely with Hardenberg for 10 years and has been an emerging markets manager at Franklin Templeton since 1995. There has been no change to the disciplined bottom-up, long-term, value-based investment process.

Sehgal is based in Singapore and is senior managing director and director of portfolio management for the Franklin Templeton Emerging Markets Equity Group. He is able to draw on a broad team of over 80 investment professionals based in 20 offices across the world. The manager aims to generate long-term capital growth from a diversified, actively managed portfolio of companies listed in emerging markets, or companies listed elsewhere that generate a significant percentage of their revenues in emerging regions. TEMIT is benchmarked against the MSCI Emerging Markets index. At the time of investment, up to 10% of assets may be allocated to a single issuer. The trust traditionally ran a small cash balance, but in January 2017, a new £150m debt facility was announced. Gearing of up to 10% of NAV is permitted; at end May 2018, net gearing was 4.1%.

The fund manager: Chetan Seghal

The manager's view: Positive outlook for emerging markets

The manager is optimistic on the growth outlook for emerging markets. Supportive factors include: robust trade, with less reliance on developed markets (for example intra-Asian trade is rising in importance); improving commodity prices, such as oil and copper; reasonably valued emerging market currencies; technology companies enjoying long-term secular growth, helped by increasing innovation; and in aggregate, emerging market firms improving their cash flows and earnings power. Coupled with these favourable growth attributes, Seghal notes the relatively attractive valuations of emerging compared with developed market equities.

There have been important political developments in the emerging market regions, such as in April 2018, when there was a meeting between North Korea's Kim Jong-un and South Korea's president Moon Jae-in. It was the first time that a North Korean leader had crossed its southern border in more than 50 years. The leaders have announced plans to end military conflict and denuclearise the Korean peninsula. Economic development in the region could provide opportunities for South Korean companies, particularly those involved in infrastructure development.

While there have been concerns about disruptions to global trade as a result of President Trump's protectionist rhetoric, the manager does not believe there will be an all-out trade war, given the importance of trade to the global economy. Investors may be concerned about rising interest rates, but so far within the US, interest rate increases have been measured. China has become an increasingly important driver of emerging-market equity performance. Its weight in the MSCI Emerging Markets index has increased from c 7% to more than 30% between end-2000 and end-2017. However, the manager notes that over time, China's economy has become more broad based, which should lead to greater economic stability. Between 1978 and 2016, agriculture has declined from c 30% to c 10% of GDP, manufacturing has declined from c 50% to c 40%, while services has increased significantly from c 20% to c 50%.

Seghal notes the low level of stock market volatility in 2017, which has increased to more normal levels so far in 2018, which may create more value opportunities. In 2017, the greatest pullback in the MSCI Emerging Markets index was just c 5%, which compares to an average c 20% over the last five years and an average c 25% over the last 20 years.

Asset allocation

Investment process: Seeking undervalued companies

The manager aims to generate long-term capital growth, seeking to invest in undervalued companies with sustainable earnings growth that can thrive in different stages of the economic cycle; he invests for the long term, avoiding short-term 'noise' in the markets. There is a five-step investment process: identification of undervalued companies; in-depth fundamental analysis; team peer review; portfolio construction; and portfolio evaluation and attribution analysis. Fundamental analysis combines both qualitative and quantitative elements, including the construction of detailed company models. The wider emerging market sector and regional developments are also assessed. When considering a potential addition to the portfolio, a review of the company's economic, social and governance (ESG) record is an increasingly important part of the investment process, in the belief that ESG standards can influence a company's financial prospects. Factors considered include the quality of the management team and the company's ownership structure. Sehgal and his team actively engage with company managements and other shareholders to monitor ESG practices and promote positive corporate changes. Under previous lead manager Hardenberg, the number of holdings in TEMIT's portfolio was roughly doubled from c 50 to c 100.

Current portfolio positioning

At end May 2018, TEMIT's top 10 positions made up 44.7% of the portfolio. This was modestly higher than 42.9% a year earlier; eight holdings were common to both periods. Exhibit 3 shows TEMIT's sector exposure – there have been only modest changes to the fund's weightings over the 12 months to end May 2018. While we compare the trust to the benchmark, it should be noted that stock selection is made on a bottom-up basis, without reference to the index.

Exhibit 3: Portfolio sector exposure vs benchmark (% unless stated)

	Portfolio end-May 2018	Portfolio end-May 2017	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Information technology	33.0	29.7	3.3	28.7	4.4	1.2
Financials	23.1	22.4	0.7	23.1	0.1	1.0
Consumer discretionary	20.0	22.3	(2.3)	9.4	10.6	2.1
Energy	8.3	8.1	0.2	7.4	0.9	1.1
Consumer staples	7.3	8.3	(1.0)	6.5	0.8	1.1
Materials	6.2	6.3	(0.1)	7.5	(1.3)	0.8
Industrials	2.6	3.5	(0.9)	5.1	(2.5)	0.5
Healthcare	1.7	1.9	(0.2)	2.9	(1.2)	0.6
Telecommunications	1.2	0.2	1.0	4.4	(3.2)	0.3
Real estate	0.5	0.6	(0.1)	2.8	(2.3)	0.2
Utilities	0.2	0.3	(0.1)	2.4	(2.2)	0.1
Other net assets	(4.1)	(3.6)	(0.5)	0.0	(4.1)	N/A
	100.0	**100.0**		**100.0**		

Source: Templeton Emerging Markets Investment Trust, Edison Investment Research

TEMIT's geographic exposure is shown in Exhibit 4. The largest weighting continues to be in China/Hong Kong, which is c 25% of the fund. Again, there have only been small changes to the trust's weightings over the 12 months to end May. Less than 5% of TEMIT's portfolio is invested in frontier markets.

Exhibit 4: Portfolio geographic exposure (% unless stated)

	Portfolio end-May 2018	Portfolio end-May 2017	Change (pp)
China/Hong Kong	25.4	22.8	2.6
South Korea	15.2	13.4	1.8
Taiwan	10.3	10.4	(0.1)
Russia	8.4	7.6	0.8
Brazil	7.5	10.0	(2.5)
South Africa	7.2	5.8	1.4
India	5.5	6.4	(0.9)
Thailand	4.3	5.2	(0.9)
Peru	3.7	2.9	0.8
Indonesia	3.6	4.9	(1.3)
Other	8.9	10.6	(1.7)
	100.0	**100.0**	

Source: Templeton Emerging Markets Investment Trust, Edison Investment Research

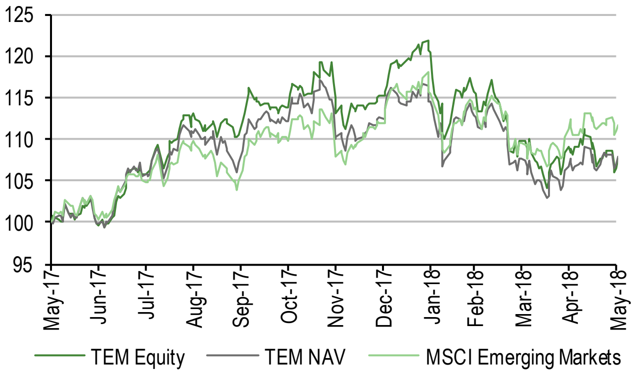
Two recent additions to the portfolio are: BAIC Motor and China Construction Bank. BAIC Motor is a major Chinese automobile manufacturer, which has joint ventures with Mercedes-Benz and Hyundai. The company is undergoing a major business overhaul, which is expected to lead to higher margins. BAIC is trading on 7.5x earnings and offers a dividend yield of 4%. China Construction Bank is one of China's largest commercial banks, with a strong deposit franchise and a robust capital position. It is trading below book value and offers a dividend yield of more than 4%.

Performance: Weaker near-term performance

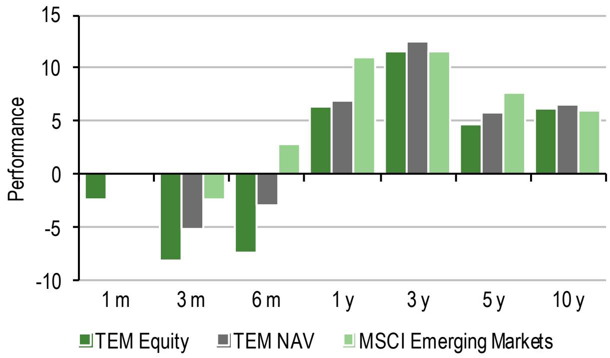
In FY18 (to end March), TEMIT's NAV and share price total returns of 12.4% and 13.7% respectively were ahead of the benchmark's 11.8% total return. Over the period, positive contributors to performance included: Brilliance China Automotive, which is benefiting from demand for luxury cars by China's rising middle classes, and Ping An Insurance, a Chinese provider of personal financial services, which reported annual earnings above consensus expectations.

Exhibit 5: Investment trust performance to 31 May 2018

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

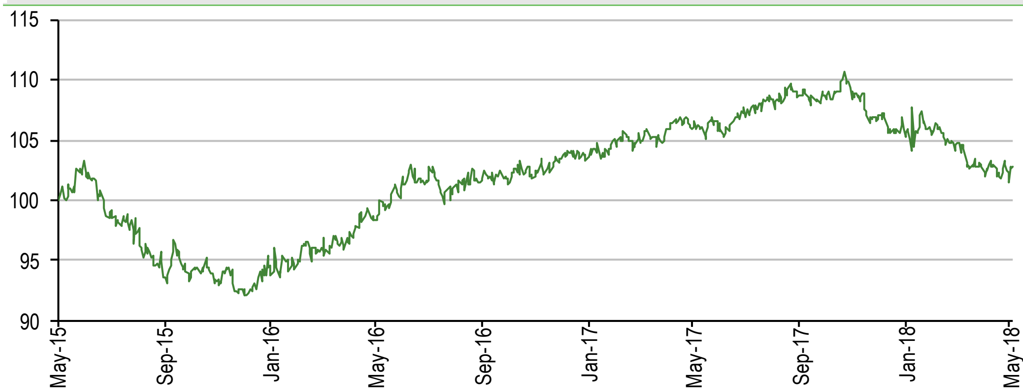
Exhibit 6 shows TEMIT's relative returns. Its NAV total returns are modestly ahead of the index over three and 10 years, while lagging over most of the other periods shown. A significant factor affecting near-term performance was share price weakness earlier in 2018, in former largest holding, Brilliance China Automotive. This was sparked by the announcement that the Chinese automotive industry will be opened up to foreign companies. The manager believes that Brilliance's share price will recover. He has confidence that its joint venture with BMW, which lasts until 2028, provides a significant competitive advantage, as foreign entrants will not be licensed to manufacture combustion-engine vehicles and the luxury car market in China continues to grow.

Exhibit 6: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to MSCI Emerging Markets	(2.3)	(5.8)	(10.0)	(4.2)	0.3	(12.7)	0.9
NAV relative to MSCI Emerging Markets	0.3	(2.9)	(5.5)	(3.7)	2.7	(8.1)	4.1
Price relative to MSCI World	(6.4)	(11.0)	(11.0)	(2.3)	(4.4)	(31.2)	(31.5)
NAV relative to MSCI World	(3.9)	(8.3)	(6.5)	(1.8)	(2.1)	(27.6)	(29.3)
Price relative to FTSE All-Share	(5.1)	(14.4)	(13.3)	(0.1)	11.9	(13.1)	(7.5)
NAV relative to FTSE All-Share	(2.6)	(11.8)	(9.0)	0.4	14.6	(8.5)	(4.6)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-May 2018. Geometric calculation.

Exhibit 7: NAV total return performance relative to benchmark over three years



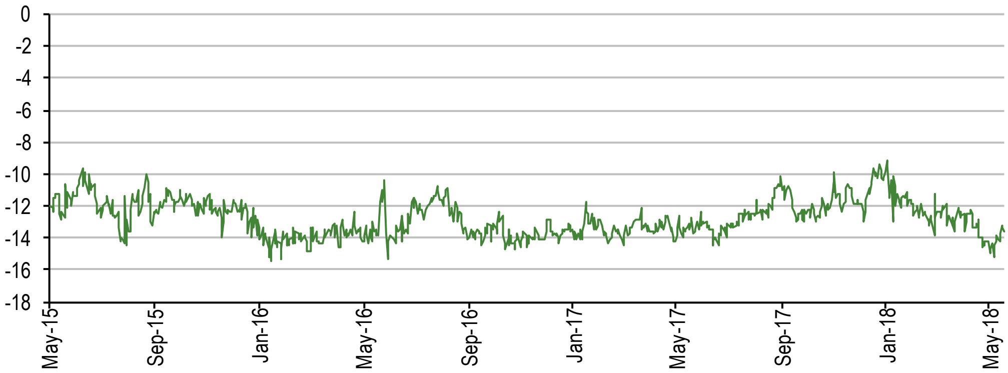
Source: Thomson Datastream, Edison Investment Research

Discount: Wider than historical averages

TEMIT's current 13.6% share price discount to cum-income NAV is towards the high end of its 12-month range of 9.2% to 15.2%. It is also wider than the averages of the last one, three, five and 10 years of 12.4%, 12.8%, 11.7% and 9.6% respectively. The board actively seeks to manage the discount by repurchasing shares (Exhibit 1); shares are bought back on the majority of trading days. In FY18, 9.7m shares (3.4% of shares outstanding at end FY17 were repurchased at a cost of c £70m), adding 0.4% to NAV per share.

The trust's persistently wide discount may reflect the perceived higher risk from investing in emerging rather than developed market equities, as a number of peers shown in Exhibit 9 are trading on similarly wide discounts. However, looking at Exhibit 8, over the last three years there have been periods when TEMIT traded at a c 10% rather than the current c 14% discount.

Exhibit 8: Share price discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

TEMIT is a conventional investment trust with one class of share in issue; there are 266.1m ordinary shares outstanding, with a further 11.8m held in treasury. The trust has a £150m unsecured, multicurrency revolving loan facility with the Bank of Nova Scotia. This may be drawn in sterling, US dollars and Chinese renminbi (up to a maximum of £30m). If the facility was fully drawn, it would equate to gearing of c 5.5%, which compares to the trust's net gearing of 4.1% at end May 2018.

Effective 1 July 2017, Templeton is paid an annual management fee of 1.0% of net assets up to £2bn, and 0.85% of net assets above this level. No performance fee is payable. (The previous management fee was a flat 1.1% of net assets.) In TEMIT's FY18 annual report, the board announced a further reduction in fees. Effective 1 July 2018, the annual management fee will be 1.0% of net assets up to £1bn, and 0.85% of net assets above this level.

Since 1 April 2017, 70% of the annual management fee and interest costs are allocated to the capital rather than the revenue account. This 70:30 ratio reflects the board's outlook for the long-term split between capital and income returns. In FY18, ongoing charges of 1.12% were 8bp lower than 1.20% in FY17. TEMIT is subject to a continuation vote, next due at the July 2019 AGM.

Dividend policy and record

TEMIT historically paid a dividend once a year in July. However starting in the current financial year (FY19), dividends will be paid twice a year in July and January. The FY18 distribution of 15.0p (1.06x covered) was 82% higher than the payment in the prior three financial years. Revenue income of 15.9p was boosted by the change in the fee allocation highlighted above. Following payment of the FY18 dividend, the trust will have c 2x dividend cover in revenue reserves. Based on its current share price, TEMIT's has a dividend yield of 2.1%.

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Peer group comparison

TEMIT is a member of the AIC Global Emerging Markets sector. In Exhibit 9, we show the eight trusts in the sector with a market cap greater than £250m; TEMIT is the largest fund by a wide margin. Its NAV total returns are above average over one, three and 10 years, but lower than the peer group average over five years. TEMIT's discount is wider than the peer group average, although at a similar level to a number of its peers. Its ongoing fee is below average and no performance fee is payable. The trust is one of three peers with gearing, and following the higher FY18 dividend, has an above-average dividend yield.

Exhibit 9: Selected peer group as at 15 June 2018*

% unless stated	Market cap (£m)	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
Templeton Emerging Markets IT	1,897.2	8.1	50.5	45.1	107.8	(13.3)	1.1	No	104	2.1
Aberdeen Emerging Markets	273.1	7.0	43.0	51.0	48.0	(14.6)	1.1	No	100	0.0
BlackRock Frontiers	303.8	4.5	42.1	67.3		7.1	1.5	Yes	121	3.5
Fundsmith Emerging Equities Trust	324.4	7.1	29.2			1.1	1.9	No	100	0.0
Genesis Emerging Markets Fund	938.0	5.7	38.5	45.2	107.3	(13.6)	1.4	No	100	1.5
JPMorgan Emerging Markets	1,056.9	8.7	55.0	64.5	114.9	(12.5)	1.1	No	100	1.3
JPMorgan Global Emerging Markets	363.6	3.9	36.2	38.8		(6.0)	1.3	No	107	3.3
Utilico Emerging Markets	465.7	(1.1)	23.9	43.2	107.0	(14.6)	0.9	Yes	100	3.5
Average (8 trusts)	**702.8**	**5.5**	**39.8**	**50.7**	**97.0**	**(8.3)**	**1.3**		**104**	**1.9**
TEM rank in peer group	**1**	**2**	**2**	**5**	**2**	**5**	**5**		**3**	**4**

Source: Morningstar, Edison Investment Research. Note: *Performance as at 14 June 2018. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

TEMIT has six directors on its board; five of whom are considered independent. The chairman is Paul Manduca; he was appointed in August 2015 and assumed his current role in November of that year. The other four independent directors and their dates of appointment are: Hamish Buchan (June 2008), Beatrice Hollond (April 2014), Simon Jeffreys (July 2016) and David Graham (September 2016). The non-independent director is Gregory Johnson. He was appointed in December 2007 and is chairman and CEO of Franklin Resources, the parent company of the investment manager. Hamish Buchan has announced his intention to retire following the July 2018 AGM; subject to shareholder approval, Charlie Ricketts will be appointed as a new director. He has more than 30 years' experience in the investment trust sector, including eight years as head of investment funds at Cenkos Securities.

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