

Templeton Emerging Markets Inv. Trust

Emerging markets picking up, but still offer value

Templeton Emerging Markets Investment Trust (TEMIT) aims to achieve long-term capital gains through investing in companies operating in emerging markets. Even though these markets have shown modest signs of picking up recently, there has been pronounced relative weakness over five years leaving valuations at attractive levels compared with developed markets. The potential for volatility needs to be acknowledged, but this could represent an opportunity for investors with a long-term view. TEMIT itself has a relatively focused portfolio, is managed with a long-term, fundamental approach and has outperformed its benchmark over five and 10 years.

12 months ending	Share price (%)	NAV (%)	MSCI Emerging Markets (%)	MSCI World (%)	FTSE All-Share (%)
30/06/11	24.1	26.3	19.4	22.3	25.6
30/06/12	(17.2)	(17.1)	(13.7)	(2.2)	(3.1)
30/06/13	5.0	8.3	6.8	23.3	17.9
30/06/14	2.7	1.8	1.7	10.6	13.1

Note: *Twelve-month rolling discrete performance. All total return in sterling terms.

Investment strategy: Fundamental stock selection

The manager's investment approach is value based and bottom up. Dr Mark Mobius leads a team that includes 51 investment professionals, who speak 27 languages and dialects between them. The investment process comprises an initial liquidity screening followed by detailed analysis, which results in an assessed value that takes into account the quality of products/services and competitive position of a company. Investments and disposals are made when market values deviate significantly from the assessed value. The long-term view, which aims to look through near-term volatility, is evidenced by the low turnover in the portfolio (8% in the last financial year).

Sector outlook: Opportunity versus volatility

Concerns over the impact of QE tapering and the normalisation of China's growth may have eased, but still have the potential to affect market expectations for, and sentiment towards, emerging markets. Nevertheless, forecasts still point to significantly faster economic growth in emerging markets and valuations are at attractive levels compared with developed markets. Reflecting this, the manager has a positive long-term view on emerging markets and sees particularly exciting opportunities in frontier markets where the trust's exposure may rise to 10% or more over time.

Valuation: Sentiment has driven wider discount

Currently, the share price stands at a discount to cum-income NAV of 9.4%, compared with the three-year average of 8.5% and the low of 4.7%, suggesting the potential for a useful narrowing if macro and geopolitical concerns continue to moderate.

Investment trusts

7 July 2014

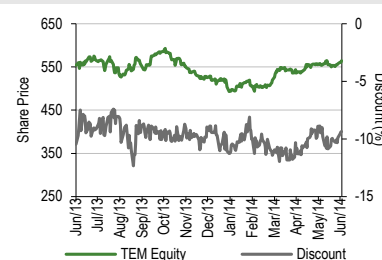
Price 564.5p
Market cap £1,818m
AUM £1,994m

NAV* 622.78p
Discount to NAV 9.4%
Yield 1.3%

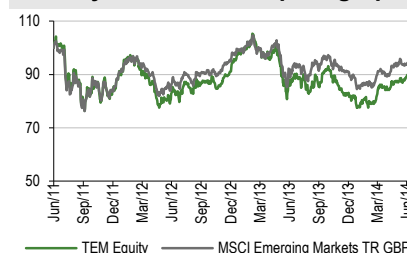
*Including income, as at 2 July 2014.

Ordinary shares in issue 322.1m
Code TEM
Primary exchange LSE
AIC sector Global Emerging Markets

Share price/discount performance*



Three-year cumulative perf. graph



52-week high/low 593.0p 493.5p
NAV* high/low 644.74p 545.10p

*Including income. Discount: negative values indicate a discount.

Gearing

Gross 0.0%
Net -4.3%

Analysts

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Exhibit 1: Trust at a glance
Investment objective and fund background

Launched in June 1989, Templeton Emerging Markets Investment Trust (TEMIT) was one of the first emerging markets funds in the UK. Dr Mark Mobius has been the manager since launch. The trust seeks long-term capital appreciation through investment in companies operating in emerging markets, or those with stocks 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. The benchmark is the MSCI Emerging Markets Index.

Recent developments

13 June 2014: Preliminary results for year to end March 2014.
20 February 2014: Ms Beatrice Hollond to join the board as a non-executive director from 1 April 2014.

Forthcoming

AGM 18 July 2014

Capital structure

Total expense ratio 1.3% (see page 7)
Net gearing -4.3%
Ann. mgmt./admin. fee 1.1% of total net assets (from 1/7/14)
Performance fee None
Trust life Indefinite
Loan facilities S-t up to 10% net assets

Fund details

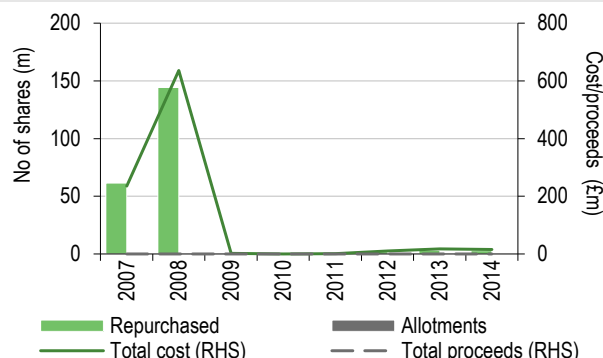
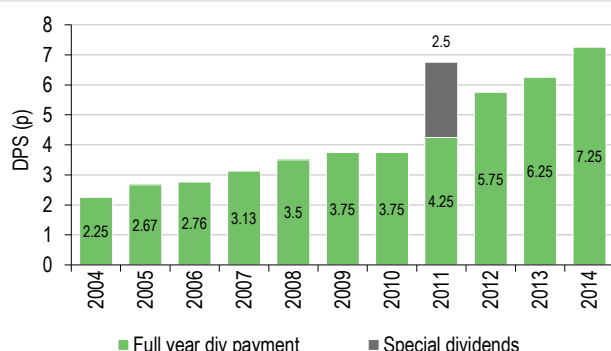
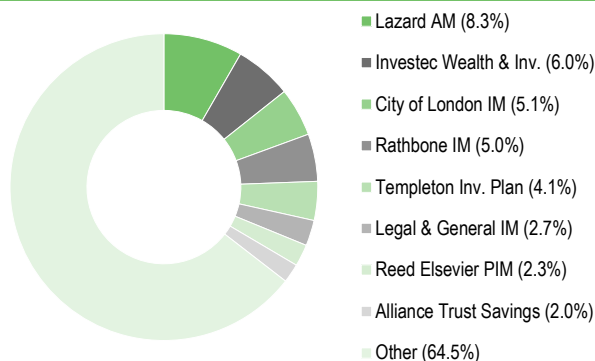
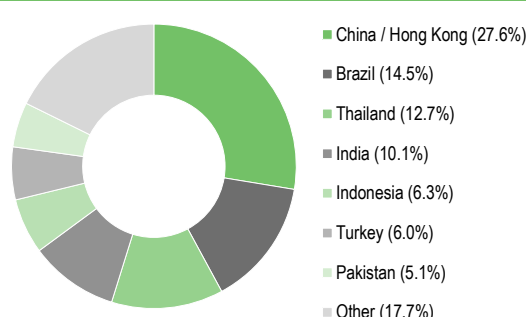
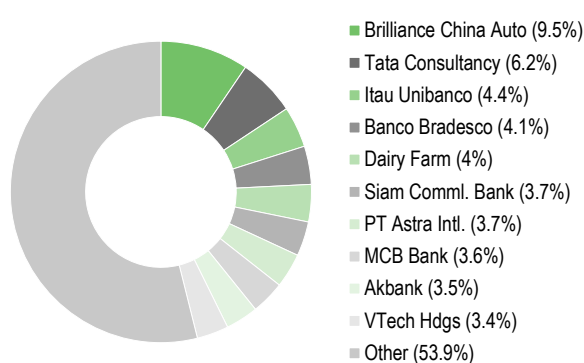
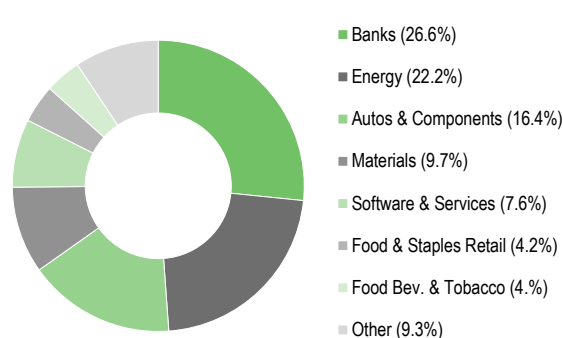
Group Templeton Asset Management
Manager Mark Mobius and team
Address 5 Morrison Street, Edinburgh, EH3 8BH, UK
Phone +44 (0) 871 384 2505
Website www.temit.co.uk

Dividend policy and history (financial years to end March)

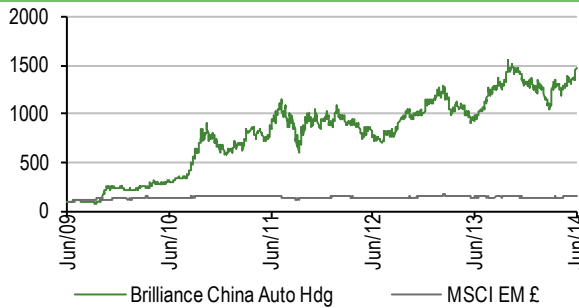
An annual payment is made with a 10-year average, normal payout ratio of 83%.

Share buyback policy and history

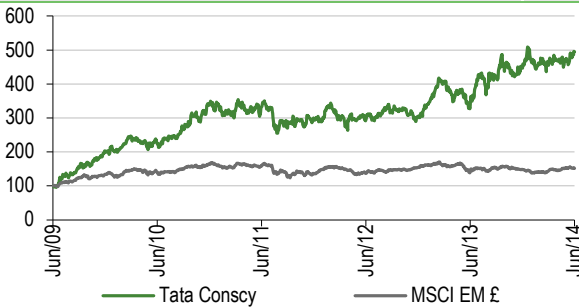
TEMIT is authorised to repurchase up to 14.99% and allot up to 5% of its ordinary shares.


Shareholder base (as at 27 June 2014)

Geographical distribution of portfolio (as at 31 May 2014)

TEMIT top 10 holdings (31 May 2014)

TEMIT sector distribution (31 May 2014)


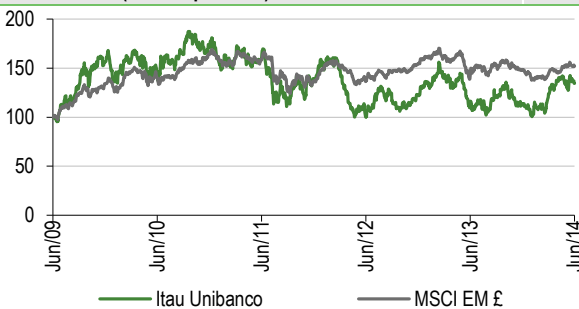
Source: Templeton Emerging Markets Investment Trust, Morningstar, Edison Investment Research

Exhibit 2: Top five holdings at a glance (end May 2014 – price-related data as at 26 June)
Brilliance China Automotive Holdings (9.5% of portfolio)
Code: 1114 HK
Market cap: HK\$70,763m (£5,376m)


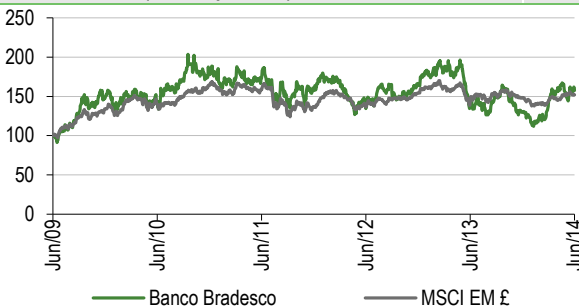
Div yield (trailing 12 months)	0.71%
Industry/Sector	Auto manufacturer/Consumer cyclical
Listing	Hong Kong
Website	brillianceauto.com
Brilliance China Automotive is a major Chinese automobile manufacturer. Its joint venture for the production and sale of BMW 3-series and 5-series in China has now been running for more than a decade, and the companies have recently agreed to extend this to 2028. Brilliance is expanding capacity and adding production of the BMW 7-series and SUVs. While TEMIT's managers took some profits during FY14, they continue to believe in the long-term growth trend in demand for motor vehicles in China as the size and spending power of the middle class increases. Brilliance China was the largest positive contributor to TEMIT's performance in FY14.	

Tata Consultancy Services (6.2% of portfolio)
Code: TCS IN
Market cap: INR4,525,735m (£44,289m)


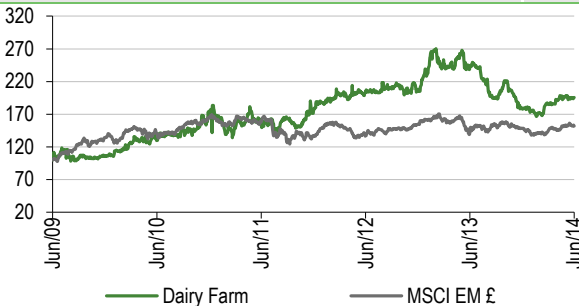
Div yield (trailing 12 months)	1.4%
Industry/Sector	Computers/Technology
Listing	National Stock Exchange of India
Website	www.tcs.com
Tata Consultancy Services is a Mumbai-headquartered IT services and outsourcing specialist with a global client base and over 300,000 employees. While there is a political impetus towards 'reshoring' in some countries and margins can be affected by currency moves given primarily rupee-denominated costs, the managers of TEMIT believe that IT outsourcing continues to be an attractive and growing industry and that Tata is well placed to benefit from this growth due to its extensive global exposure and comprehensive range of services. TEMIT's holding was trimmed in FY14 to take profits and raise funds.	

Itau Unibanco (4.4% of portfolio)
Code: ITUB US
Market cap BRL174,406m (£46,385m)


Div yield (trailing 12 months)	0.59%
Industry/Sector	Banks/Financial
Listing	BM&FBovespa
Website	itau.com.br
Itau Unibanco is a dominant player in the Latin American banking market. It is the largest private sector bank in Brazil and one of the top 20 in the world, with a network of over 5,000 branches, approaching 28,000 ATMs and about 95,000 employees. It is a universal bank with a range of services and products serving both individuals and companies of all sizes, from major transnational groups to local micro-entrepreneurs. While there is a free float of 54%, family owners control nearly 90% of the voting shares contributing to the long-term view taken in developing the business; the heavy investment made in technology for retail banking is evidence of this approach.	

Banco Bradesco (4.1% of portfolio)
Code: BBDC BC
Market cap: BRL138,945m (£36,953m)


Div yield (trailing 12 months)	3.0%
Industry/Sector	Banks/Financial
Listing	BM&FBovespa
Website	bradesco.com.br
Bradesco (BBDC) is one of Brazil's largest financial conglomerates, providing a full range of banking and financial services. The manager regards BBDC as a strong beneficiary of growth in demand for financial and banking services in Brazil due to its extensive coverage of the Brazilian territory and strong retail presence with 74.6m clients. Net income is split 70/30 between banking and insurance; the insurance business is the largest in Latin America. Both profitability and balance sheet are sound, with a return on average adjusted equity of 20.5% (Q114) and a tier I ratio of 10.9% allowing for the full impact of new central bank rules.	

Dairy Farm (4.0% of portfolio)
Code: DFI SP
Market cap: US\$14,157m (£8,337m)


Div yield (trailing 12 months)	3.5%
Industry/Sector	Retail staples/Consumer staples
Listing	LSE, Singapore
Website	dairyfarmgroup.com
Dairy Farm, a member of the Jardine Matheson Group, is held as a leading pan-Asia retailer that also processes food and wholesales food and personal hygiene products. At the end of 2013, the group had nearly 5,900 outlets and generated annual sales of \$12.4bn in 12 different Asian markets. Food and health and beauty retailing account for 70% of profits. The company's aim is to "bring to Asian consumers the benefits of modern retailing". The business has a number of strong brands in the region and benefits from a sound balance sheet with net cash of over \$600m at the year end. The business is continuing to invest in increasing the customer count across its business categories despite experiencing some margin pressure.	

Source: Templeton Emerging Markets IT, Thomson Datastream, Bloomberg, Edison Investment Research. Note: Charts are all total return in £.

Emerging market outlook: Growth and value

Emerging markets have been held back over the last year by concerns surrounding QE tapering and China's growth moderation: the MSCI Emerging Markets Index was down more than 5% in the year to end May, whereas the MSCI World Index was up 8%. Over three years emerging markets have underperformed the world market by nearly 33%. This has left emerging markets looking significantly cheaper than developed markets. The emerging markets' forward P/E ratio is 10.2x versus 14.6x for the world index (figures to end May). Price to book (1.5x versus 2.0x) and dividend yield (2.7% versus 2.5%) comparisons are also favourable.

As far as GDP growth expectations are concerned, the latest IMF estimates still show emerging market growth well ahead of advanced markets (an average 5.3% versus 2.3% 2014-19, for example). While the connection between earnings and GDP growth is not direct and there are significant political and economic risks, the gap in valuation measures and GDP forecasts suggests this may be an interesting entry point for investors, particularly those that share TEMIT's long-term time horizon.

Fund profile: Emerging market pioneer

Launched in June 1989, TEMIT is an investment trust quoted on the London (LSE) and New Zealand stock exchanges. TEMIT was one of the first pure emerging markets funds in the UK and is the largest UK global emerging market investment trust by some margin, with a market cap of over £1.8bn. The benefit of this scale for investors is primarily the resulting liquidity, while Templeton Asset Management's overall capability in emerging markets, with a total of £26.1bn of emerging market AUM (end March 2014), supports a significant local infrastructure with 18 offices globally.

The fund manager: Mark Mobius

The manager's view: A long-term perspective

The 25th anniversary of the launch of TEMIT in June 1989 has provided a useful opportunity for Mark Mobius and the management team to frame the outlook for the portfolio within a longer historical context. Among the key changes over this period has been the broadening of the investment opportunity as markets opened to external investment and expanded in tandem with economic growth: an indicator of this is that the MSCI Emerging Markets index included 10 countries on its launch in 1988 (c 1% of world market cap) expanding to 23 markets with 823 constituents currently (c 11% of world market cap).

In talking about the history and prospects, Mobius underlines the benefit of taking a long-term view as an investor in these markets, both in terms of his approach as a manager and for investors in TEMIT. The adoption of a long-term view in selecting stocks is a key element of the manager's process (see next section) and from the perspective of investors in TEMIT there are benefits to be derived from the compounding effect of remaining invested and weathering the volatility that characterises emerging markets during market cycles. Since inception, TEMIT has delivered an annualised NAV total return of 13.5% compared with 10% for the MSCI Emerging Markets index and 7% for the MSCI World index.

Looking ahead, this perspective helps the manager look through near-term political challenges (Thailand, Ukraine) to the potential positive effects of reforms (China) and the adoption of mobile technology that fosters social development. Mobius' positive view on emerging markets reflects an expectation of continued growth ahead of advanced economies, generally relatively favourable debt to GDP ratios, high foreign exchange reserves, the prospect of attractive earnings growth and modest current valuation measures in comparison with developed markets.

Asset allocation

Investment process: Bottom-up fundamental research

The manager follows a research-driven investment approach with substantial resources to support it. Templeton Asset Management has offices in 18 countries and 51 portfolio managers, analysts and product specialists, who between them speak 27 languages and dialects (March 2014).

The research and portfolio construction process is summarised in the following five steps:

- Identify opportunities: a master list is compiled by screening for securities matching liquidity and market cap requirements.
- Analyse companies: detailed research of the company's industry and financial accounts, together with a company visit to assess management, product/service quality, customers and competitive position.
- Construct action list: following peer review, each company is allocated buy and sell price targets based on the analysis and valuation undertaken. A company's potential earnings on a five-year view, asset value and cash flow generation feed into this judgement.
- Allocate portfolio to provide best combination for growth and diversification: a weekly review ensures consistency in the portfolio and compliance with investment committee guidelines.
- Evaluate and monitor portfolio: stocks in the portfolio are monitored against updated target prices, and contact with company management and competitors is maintained.

The aim of the investment risk management approach is to ensure risks are recognised, rational and rewarded. Risks at a security, sector and country level are identified and monitored independently by Templeton Asset Management's global risk management team.

The company takes the view that foreign exchange exposure is an inherent risk of emerging market investment and therefore does not hedge exposure, avoiding the associated costs.

Mark Mobius, as team leader, has encouraged a strongly collegiate approach. Personnel turnover has been low and, as a result, he has colleagues who have worked with him for over two decades (senior members of the team include Allan Lam, Chetan Sehgal and Carlos Von Hardenberg).

Portfolio positioning

As at the end of May 2014, the top 10 holdings accounted for 46% of net assets, equities were 95.7% of assets and cash/current assets 4.3%. There were 47 holdings at the end of March 2014 compared with over 820 in the MSCI benchmark index and the list of c 1,300 stocks from which TEMIT selects holdings.

As illustrated in Exhibits 3 and 4, sector and geographic allocations have some substantial differentials when compared with the benchmark, reflecting the manager's focus on stock selection. By sector, TEMIT's largest active overweight positions are in energy and consumer discretionary, reflecting the consumer/commodity themes pursued by the manager. At the other end of the scale, larger active underweight positions are telecoms, information technology and utilities reflecting a combination of valuation and regulatory considerations. Over the last year the exposure to the financials sector has fallen by nearly 4% points and materials by nearly 3% points, with balancing increases in cash, energy and information technology.

Geographically, the largest active overweights are Thailand, Hong Kong/China and Pakistan, which together account for 45% of the trust's portfolio. The portfolio at end March had 6.9% exposure to frontier markets, a percentage that Mark Mobius sees as potentially rising to 10% over time given the attractive long-term opportunities for growth.

Turnover in the portfolio has remained relatively low (at 8% last financial year) reflecting the long-term view taken, although there have been periods of greater activity (2004 and 2007 saw turnover of over 20%). In the last financial year to end March two new holdings were added: Oil & Gas Development (Pakistan) and Unilever (UK), while there were four complete sales, the largest of

which was PKN Orlen (Poland, refining, petrochemicals). Since then a holding in Industries Qatar has been initiated (giving exposure to the growing non-oil activity in the country) and holdings in Anglo American, Sesa Sterlite and Walmex have been sold to fund more attractive opportunities.

Exhibit 3: Sector allocations as at end May 2014

	Trust weight (%)	Benchmark weight (%)	Trust active weight (%)	Trust weight/ benchmark weight
Energy	22.2	10.8	11.4	2.1
Consumer Discretionary	16.9	9.0	7.9	1.9
Financials	28.0	26.9	1.1	1.0
Materials	9.7	9.0	0.7	1.1
Consumer Staples	8.2	8.4	-0.2	1.0
Healthcare	0.0	1.7	-1.7	0.0
Industrials	3.9	6.5	-2.6	0.6
Utilities	0.0	3.5	-3.5	0.0
Information Technology	11.1	17.2	-6.1	0.6
Telecommunication Services	0.0	7.0	-7.0	0.0
Total	100.0	100.0	0.0	

Source: TEMIT, Edison Investment Research. Note: Ranked by active weight.

Exhibit 4: Geographical allocations as at end May 2014

	Trust weight (%) May 2014	Benchmark weight (%) May 2014	Trust active weight (%)	Trust weight/ benchmark weight
Thailand	12.7	2.2	10.5	5.9
China / Hong Kong	27.6	18.6	8.9	1.5
Pakistan	5.1	0.0	5.1	N/A
Turkey	6.0	1.8	4.2	3.4
Indonesia	6.3	2.6	3.7	2.4
Brazil	14.5	10.8	3.7	1.3
Other	22.4	19.4	3.0	1.2
Malaysia	0.0	3.8	-3.8	0.0
Mexico	0.0	5.1	-5.1	0.0
South Africa	1.1	7.7	-6.6	0.1
South Korea	4.4	16.1	-11.7	0.3
Taiwan	0.0	12.1	-12.1	0.0
Total	100.0	100.0	0.0	0.0

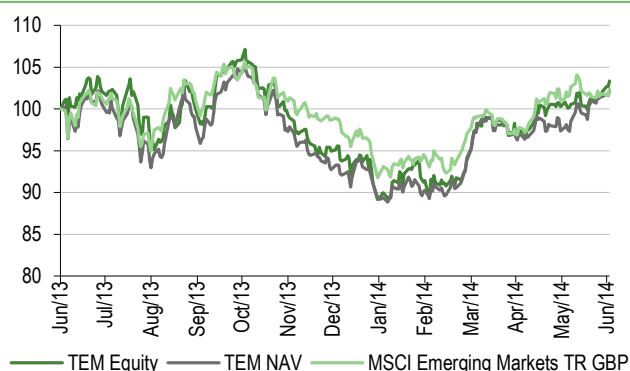
Source: TEMIT, Edison Investment Research. Note: *Other countries include India, Russia, the UK and Peru. Ranked by active weight.

Performance: Long-term outperformance

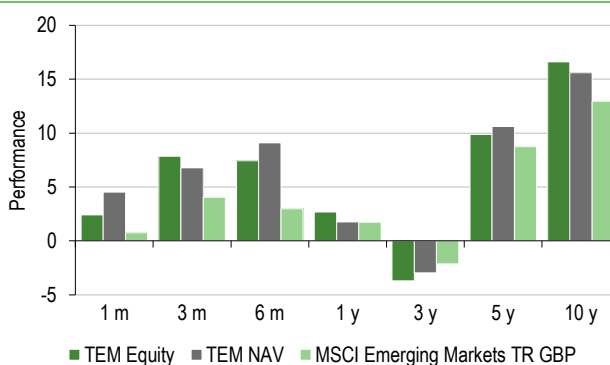
The NAV total return has outperformed the fund's benchmark over five and 10 years, performing in line over one year and slightly behind over three years, a period of negative returns for emerging markets (Exhibits 5 and 6). The outperformance of TEMIT, and its benchmark, relative to the FTSE All-Share over 10 years points to the merits of taking a long view when investing in these relatively volatile markets.

Exhibit 5: Investment trust performance

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 returns are annualised.

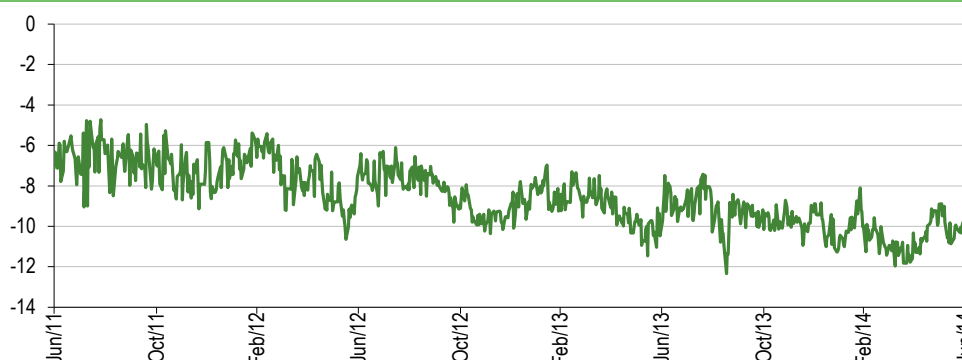
Exhibit 6: Cumulative share price and NAV total return relative performance (geometric calculation)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to MSCI EM £	1.7	3.7	4.3	0.9	(4.8)	5.2	37.6
NAV relative to MSCI EM £	3.8	2.6	5.9	0.0	(2.5)	8.8	25.9
Price relative to MSCI World £	2.5	5.3	4.1	(7.2)	(33.1)	(19.6)	106.4
NAV relative to MSCI World £	4.6	4.2	5.7	(8.0)	(31.6)	(16.8)	88.9
Price relative to FTSE All-Share Index	3.7	5.5	5.8	(9.2)	(30.9)	(18.6)	103.5
NAV relative to FTSE All-Share Index	5.9	4.4	7.4	(10.0)	(29.3)	(15.8)	86.2

Source: Thomson Datastream, Edison Investment Research. Note: Data to end June 2014 and indices £ adjusted.

Discount: Off recent highs, but above average

The company has not made a commitment to maintain the discount of the share price to the NAV at a particular level, but recognises that investors value stability, and the TEMIT board exercises the right to buy back shares selectively to limit discount volatility. In its last financial year, to end March 2014, the company bought back shares equivalent to 1.4% of the share capital. Previously, following the financial crisis, the discount widened to a high of 14.1% in FY09 and the company bought back and cancelled just over 30% of the shares in issue, primarily through a tender offer in June 2008 at a cost of £611.2m (see Exhibit 1). The current discount of 9.4% is above the three-year average of 8.5% and still significantly above the low of 4.7%, suggesting useful scope for a narrowing on improving sentiment.

Exhibit 7: Percentage discount of price to cum-income NAV over three years


Source: Datastream, Edison Investment Research. Note: Negative values indicate a discount.

Capital structure and fees

TEMIT has a conventional capital structure with one class of ordinary share in issue. In exceptional circumstances, the trust is permitted to borrow up to 10% of net assets and has a short-term borrowing facility in place. This borrowing facility has not been used in recent years. Templeton Asset Management receives a management/administration fee of 1.2% per year of total net assets; from 1 July 2014 this will be reduced to 1.1% (an 8% reduction). There is no performance fee. The management contract is of unlimited duration and can be terminated without compensation, providing at least one year's notice is given. The ongoing charge for the year to March 2014 was 1.3%, and is likely to fall to c 1.2% following the fee reduction. TEMIT has an indefinite life subject to a continuation vote every five years (the next one takes place at the AGM in July 2014).

Dividend policy and record: Capital growth priority

An annual dividend of 7.25p has been proposed for the year to end March 2014. As an emerging market pioneer with a mandate directed to long-term capital growth, income is not a priority for the trust, although the policy is to have a reasonably full distribution of revenues.

Peer group comparison

The AIC Global Emerging Market sector includes 10 peers (counting the Ashmore Global £/US\$ funds separately and excluding the new Fundsmith fund for the moment). There is a variety of styles in this group, with an Africa fund, fixed income and frontier markets, as well as more general equity funds such as TEMIT. Looking at the NAV total returns over one, five and 10 years, TEMIT ranks fourth, fourth and first (of four) respectively. In terms of fees, TEMIT was, despite its size, only in line with the average (before the fee reduction mentioned earlier) but is one of only two companies not to charge performance fees.

Exhibit 8: Global emerging markets sector

Fund Name	Market Cap £m	NAV TR 1 Year (%)	NAV TR 5 Year (%)	NAV TR 10 Year (%)	Sharpe ratio 1y (NAV)	Sharpe ratio 3y (NAV)	Discount (Ex Par %)	Ongoing charges (%)	Perf fee	Net gearing *	Yield (%)
Advance Developing Markets	223.3	2.2	39.7	192.5	(0.6)	(0.2)	(11.5)	1.1	Yes	93.0	0.0
Advance Frontier Markets	99.6	11.2	57.5		0.6	0.7	(6.6)	1.5	Yes	97.0	0.0
Africa Opportunity	27.9	(12.5)	78.5		(0.1)	0.3	3.4	2.9	Yes	99.0	0.6
Ashmore Global Opp GBP	67.7	(22.4)	(27.9)		(2.3)	(1.5)	(24.2)	2.5	Yes	83.0	0.0
Ashmore Global Opp USD	39.0	(29.1)	(31.2)		(2.4)	(1.6)	(20.7)	2.5	Yes	83.0	0.0
BlackRock Frontiers	182.3	17.1			1.6	0.9	2.2	1.7	Yes	101.0	2.9
Genesis Emerging Markets	752.4	6.3	74.5	310.7	(0.3)	0.1	(4.6)	1.7	No	98.0	0.0
JPMorgan Emerging Markets	668.4	0.4	59.9	309.9	(0.5)	(0.0)	(10.1)	1.1	Yes	95.0	1.0
JPMorgan Global Emerg Mkts	334.2	3.6			(0.3)	0.4	4.0	1.2	Yes	105.0	4.2
Templeton Emerging Markets	1811.6	6.7	67.6	335.4	(0.5)	(0.1)	(9.7)	1.3	No	96.0	1.3
Utilico Emerging Markets	389.7	9.5	93.3		(0.3)	0.4	(7.2)	0.9	Yes	105.0	3.3
Weighted average		5.2	65.9	315.8	(0.4)	0.0	(7.5)	1.3		97.4	1.8
TEMIT Rank		4	4	1	8	8	7	7		7	4
Count		11	8	4	10	10	10	10	10	10	10

Source: Morningstar. Note: As at 4 July 2014. TR = percentage total return. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. *Net gearing is total assets less cash/cash equivalents as percentage of shareholders' funds.

The board

The board comprises seven non-executive directors, six of whom are independent of Franklin Templeton Investments: Peter A Smith (chairman), Christopher D Brady, Hamish N Buchan, Sir Peter Burt (who will retire from board at the AGM, 18 July), Neil A Collins, Peter O Harrison and Beatrice Hollond who joined the board as a non-executive director from 1 April 2014. The non-independent director is Gregory E Johnson, who is president and CEO of Franklin Resources, the parent of the investment management company.

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