Fund Commentary

FTIF Templeton Global Balanced Fund (Equity & Fixed Income)

Fourth Quarter 2009

Overview

- Equities saw modest gains over the quarter as economic activity firmed and corporate earnings exceeded forecast, overcoming a headwind from bond markets.
- For the quarter ended 31 December 2009, the fund rose by 1.99% net in U.S. dollars, underperforming its benchmark comprising a 65% weighting in the MSCI World Index and 35% in the JPM Global Government Bond Index, which rose by 2.07%.
- Individual equity investments, notably Telenor, Oracle and Microsoft, generated strong performances, but disappointing returns from European telecoms and materials offset the gains, leaving the fund's overall equity performance behind that of its benchmark.
- The fund manager added a number of new holdings from our buy list while raising funds from stocks whose prospects were more fully represented in their prices.
- In the fixed income portion of the fund, relative outperformance was mainly attributable to currency positions followed by sovereign credit exposures, while interest-rate strategies modestly contributed.
- Currencies that contributed the most to relative performance were ones in which the fund was significantly underweighted, such as the euro and the Japanese yen. The fund's sovereign credit exposure in Russia, Argentina, Indonesia and Hungary delivered strong relative returns over the quarter. Among the fund's key interest-rate strategies, duration exposures in Europe and Asia added to relative performance, while duration positions in the Americas slightly detracted.

Market Review

Economic progress continued over the quarter, strongest in China and its satellites, but with signs of progress in the developed world as well although Japan was subdued. A favorable corporate results season boosted earnings forecasts, and high demand pushed commodity prices ahead with some limited knock-on inflation effects. Financial policy remained supportive as bank lending remained sluggish. Materials stocks led modest market gains, though information technology and health care also performed well. Utilities saw little change and financials lost ground. During the final quarter of 2009, and particularly in December, global fixed income markets began to price in a higher degree of differentiation. The previous months' indiscriminant rally lost steam, and many assets traded sideways. The Dubai World debt standstill and the downgrade of Greece were the biggest headlines during the quarter, but other overleveraged countries in Europe also suffered, and realization dawned that certain government bond issues faced very difficult economic outlooks even as the global economy began to recover. Nonetheless, data from emerging markets in Asia as well as select developed and Latin American economies confirmed our thesis that a recovery was underway there.

Performance Review and Contributors to Performance

Leading positive contributions to performance in the fourth quarter, Norwegian telecoms business Telenor advanced as resolution of a potentially crippling legal dispute with a Russian partner shifted market attention to the group's low valuation and attractive mix of businesses. U.S. database management group Oracle raised its earnings guidance after stronger-than-expected results for its second quarter due to solid sales across its businesses, effective cost management, and progress in plans to acquire Sun Microsystems. Software giant Microsoft rose on strong third-quarter profits, a buoyant debut for the Windows 7 operating system and optimism about other new product launches due in 2010.

Telenor aside, telecoms generally disappointed. Telekom Austria fell particularly sharply following a profit warning and the shelving of plans for a share buy-back program, though the stock's generous dividend remained in place. The fund's low weighting in materials hampered returns as metal and mining stocks performed strongly. Elsewhere, Dutch reinsurer ING Groep was notably weak on a capital raising, a European Union-enforced restructuring and unease about its holdings of sovereign debt. The overall equity return modestly lagged the equity benchmark.

In the fixed income portion of the fund, relative outperformance was mainly attributable to currency positions followed by sovereign credit exposures, while interest-rate strategies modestly contributed. On the currency side, the U.S. dollar strengthened over the quarter, particularly relative to other major currencies but not against most peripheral and emerging market currencies. As a result, the currencies that contributed the most to relative performance were ones in which the fund was significantly underweighted such as the euro and the Japanese yen. Positions in the Polish zloty, Indonesian rupiah, Indian rupee, Malaysian ringgit, South Korean won, Mexican peso, Chilean peso, and Brazilian real were also beneficial. The fund's sovereign credit exposure in Russia, Argentina, Indonesia and Hungary delivered strong relative returns over the quarter. Among the fund's key interest-rate strategies, duration exposures in Europe and Asia added to relative performance, while duration positions in the Americas slightly detracted.

Strategy and Activity

Global Equity Strategy

The fund manager added a number of new holdings from our buy list, including European software and utility businesses, a U.S. natural gas producer and a Japanese trading company, while raising funds from an emerging market telecommunications business, a European staffing company, an Internet security business and a semiconductor production-equipment designer; positions sold reflected prospects that were more fully represented in their prices. The fund has high weightings in telecoms, consumer discretionary and health care balanced by low weightings in financials, materials and consumer staples, which offer fewer attractive opportunities according to our research.

Global Fixed Income Strategy

We expect the differences between the prospects for individual economies will be an important driver of financial markets in 2010 as domestic demand recovers robustly in some economies while others lack a driver to sustain a recovery and continue to struggle with deleveraging. Across developed and emerging markets, different growth patterns and fiscal outlooks could provide opportunities for positioning in sovereign credit. While emerging market sovereign bond spreads have narrowed from crisis-driven levels, we continue to find value in the sector. Indeed, the slow growth environment has created financing needs in some countries with solid credit fundamentals that have not issued in several years. An assessment of individual countries' fundamental growth and inflation prospects will also provide important guidance to our positioning in global interest rates and currencies. In particular, we would expect Asian currencies to be supported over the medium term against the G-3 (the U.S., Japan and the eurozone), in light of the far stronger recovery in Asia relative to much of the developed world.

We also continue to expect that higher fiscal deficits in the U.S. will result in higher Treasury yields. We hold no U.S. Treasuries and very little duration exposure in other developed government bonds. Further, we are pursuing ways that will allow our portfolios to be not only cushioned against rising yields but also to potentially capitalize on them. This could take the form of negative duration exposure through derivative instruments or currency positioning. For example, there is a strong correlation between U.S. and Japan treasury yield differentials and the Japanese yen exchange rate. The narrowing of the U.S.-Japan interest-rate differential supported the yen against the dollar through much of 2009, but if U.S. yields rise, reversing the interest-rate convergence, the yen may weaken. Thus, our negative exposure to the yen serves as an indirect hedge against the potential rise in U.S. yields. We also like being long commodity currencies (such as the Norwegian krone and the Australian dollar), which we expect to outperform due to stronger domestic economies. These currencies could also outperform in an environment of rising interest rates caused by higher global growth.

Investment Outlook

Entering 2010, global economies appear set for a cyclical recovery. Equity earnings forecasts remain on an upward trend, and the outlook for share prices appears broadly favorable. However, the recent weakening in bond markets highlights the challenges facing governments and central banks in weaning markets off monetary and fiscal stimulus and repairing public finances without halting economic recovery or igniting inflation. We believe the equity portion of the portfolio offers a useful yield and solid prospects for capital growth as economic growth feeds into earnings and the valuation anomalies that we have identified are corrected.

In our fixed income strategy, we believe that differentiation is going to be an increasingly important factor in financial markets, and country fundamentals should be a major driver of such differentiation. Fiscal developments and growth potentials are two of the most relevant factors in this regard. The crisis has triggered a significant increase in fiscal deficits and public debt ratios in a number of countries, and the size and distribution of this deterioration might lead to a significant change in the way that markets assess the creditworthiness of many countries. First of all, on average, the fiscal deterioration has been much more severe in developed countries than in emerging markets, as the former have had to transfer much of the losses incurred by the private financial sector onto the public balance sheet. As developed markets, in general, also have lower growth potential, they will find it harder and more painful to improve their fiscal balances. Markets are therefore likely to charge increasing risk premiums to some of these developed markets, and this might in some cases blur the traditional distinction between 'developed' and 'emerging' markets. This is evident in Europe, with the difficulties currently faced by Greece a specific case in point.

While the U.S. also faces a difficult fiscal situation, its better growth prospects relative to the eurozone and Japan are an important asset, and should help the U.S. dollar reverse its recent weakness against the yen and euro. The possible recovery of the U.S. dollar against other major currencies would be driven by stronger confidence in the sustainability of the U.S. recovery and would be consistent with healthy levels of risk appetite in markets.

Fund performance as of end of period under review:

	1-mth	3-mth	6-mth	1-year	3-year	5-year	Since Launch (01/06/94)
Total Return	1.1%	2.0%	18.4%	21.3%	-9.1%	10.3%	138.0%
AACR[1]	N/A	N/A	N/A	15.2%	-4.8%	0.9%	5.4%

Source: Franklin Templeton Investments. Fund performance computed in share class currency, on NAV-NAV basis and dividends reinvested.

[1] *Average annual compounded return of Fund, taking into account relevant initial sales charge.*