

FTIF Templeton BRIC Fund

January 2010

For the month ended 31 January 2010, FTIF Templeton BRIC Fund fell by 7.65% (in U.S. dollars), while the MSCI BRIC TR Index which fell by 7.48% (also in U.S. dollars).

Optimism continued in the early part of January, with BRIC markets reaching their highest level in more than a year on January 11. However, market sentiment was then dampened by concerns about the strength of the global recovery, China's tightening policies, Greece's high debt levels and U.S. President Barack Obama's proposal for greater regulation and taxation of the U.S. financial sector. We believe the actions taken by the Chinese government are unlikely to derail the country's broader economic recovery. Among the BRIC markets, Russia was the top performer for the month, gaining 2.39% in U.S.-dollar terms, while Brazil was the greatest underperformer, with a 10.93% decline in U.S.-dollar terms due to a weaker real.

Private consumption in Brazil continued to grow in the latter part of 2009, while inflationary pressures remained stable, with consumer prices rising 4.3% year-over-year in December, within the central bank's target range. Brazil remained one of the most attractive destinations for foreign direct investment (FDI) in the emerging market asset class in 2009, with FDI inflows totaling US\$9.7 billion in 2009 and accounting for about 60% of the total flowing into Latin America.

Russia's industrial sector continued to strengthen, with production rising for the fourth consecutive month in December on a month-over-month basis. Manufacturing output recorded its first annual growth in more than a year with a 0.7% increase in December. Inflationary pressures continued to ease, with consumer prices increasing 8.8% year-over-year in 2009, lower than the 13.3% year-over-year rise in 2008 and the lowest since 1992. This allowed the central bank to maintain an expansionary monetary policy, cutting the benchmark interest rate by 25 basis points to 8.75% at the end of December.

In January, the Indian government raised its gross domestic product (GDP) growth forecast for the fiscal year ending March 2010 to 7.8%. Government stimulus measures, low interest rates and greater domestic demand are expected to further support growth. The central bank announced a 75 basis point increase in the cash reserve ratio to 5.75% in January in an effort to reduce excessive liquidity in the system, help maintain price stability and curb rising inflationary pressures. However, it left benchmark interest rates unchanged. Wholesale inflation rose 7.3% year-over-year in December, higher than the 4.8% year-over-year increase recorded in November and the fastest rise in more than a year.

China's GDP growth accelerated to 8.7% year-over-year in 2009, exceeding the government's 8% target, supported by an expansionary credit policy, greater public expenditure and consumer demand. Exports recorded positive growth in

December, the first in more than a year, while economic recovery and improving domestic demand led consumer prices to their second consecutive monthly increase after nine months of decline. In January, the People's Bank of China switched to a tightening monetary policy to curb excessive credit growth, raising the reserve ratios for banks by 50 basis points to 16% for the country's largest banks and 14% for the smaller banks. Yields on government bonds were also raised.

Portfolio inflows during the month and our continued search for attractively valued stocks led us to increase the fund's investments in China, via the Hong Kong-listed "H" and Shanghai "B" shares, as well as in Russia, Brazil and India. We also increased the fund's holdings in industries such as banking, oil and gas, metals and mining, coal and consumable fuels, and real estate management and development.

Outlook

Our long-term outlook for BRIC markets continues to be positive. We believe that these markets are in a secular bull phase and that their general direction could continue to be upward, although there will likely be corrections along the way, given their volatile nature.

Currently, the biggest risk we see to markets worldwide is the level of derivatives. The total value of derivatives is now over US\$600 trillion, 10 times more than the total economic output of the world.¹ These derivatives could contribute to asset bubbles as we have seen in the real estate market in the U.S. Another risk is in the form of money supply—if we were to see a sudden sharp decline in money supply, it could start a downward trend in the markets. Other risks include the loss of investor confidence, over- or poor regulation in various industries, adoption of protectionist measures, or abandonment of the market economy philosophy.

A number of factors strengthen our belief in emerging markets. First, gross domestic product (GDP) growth in emerging markets is much higher than in developed markets. According to the International Monetary Fund, in 2010 China and India are expected to grow by 9.0% and 6.4%, respectively, and emerging markets in general are expected to grow 5.1%, while developed markets are expected to grow just 1.3%. Second, foreign reserves in emerging markets have surpassed that of developed countries since 2005 and continue to build up. China has over US\$2 trillion in reserves, while Japan, which used to be the largest holder, has half as much. Russia, Brazil and India are also significant holders of foreign reserves. Third, the debt-to-GDP ratio in these countries is much lower than in developed countries.

Fourth, emerging markets, especially the BRIC countries, are becoming less reliant on developed markets. While emerging market growth cannot be totally separated from that of developed markets in terms of trade and capital flows, it is evident that as time goes by, the BRIC markets are becoming less dependent on trade with the U.S. In Asia, this is particularly prevalent as exports from all over Asia are going to China rather than to the U.S. or Europe. In fact, China now is the major export destination for many Asian countries. Domestic growth within the BRIC markets is also stimulating internal demand, which is picking up dramatically, boosted by government subsidies.

Fifth, inflation in these markets has been coming down at a very fast pace since the middle of 2008, which has been accompanied by lower interest rates. A rise in interest rates could have a negative impact on markets if inflation does not rise at the same time. But if inflation rises faster than interest rates, the impact may not be as negative. Over the long term,

¹ Bank of International Settlements, Semiannual OTC derivatives statistics at end-June 2009.

higher interest rates do not necessarily lead to a falling stock market because they would indicate a demand for creditors and mean that businesses are recovering, but in the short term they could have an impact. It is important to remember, however, that interest rates are only one of the factors that impact markets and that many other factors come into play.

The rapid developments in the BRIC markets could allow them to command even greater attention in the global investment universe. We believe Brazil, Russia, India and China could become some of the world's most important and influential countries. We could see more money being directed into these markets over the next 10 years, as investors realize that they may be able to buy good value at reasonable prices with relatively lower risk, compared to developed markets. Indeed, a number of these markets experienced a rapid run up over the past several months. Therefore, we must pay attention to valuations and long-term earnings growth prospects in order to avoid buying or holding expensive stocks. Despite recent sharp rises, we are still able to find opportunities, and in our opinion, current valuations are below their five-year historical highs and do not appear excessive.

Fund performance as of end of period under review:

	1-mth	3-mth	6-mth	1-year	3-year	5-year	Since Launch (25/10/05)
Total Return	-7.7%	1.2%	12.1%	86.1%	0.9%	N/A	65.4%
AACR ¹	N/A	N/A	N/A	76.8%	-1.4%	N/A	11.2%

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.

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