Templeton Emerging Markets Inv. Trust

Improving relative performance

Investment trusts

Templeton Emerging Markets Inv. Trust (TEMIT) aims to generate long-term capital growth from a diversified portfolio of emerging market equities. Since the change in manager in October 2015, there has been a notable improvement in TEMIT's relative performance – over the last 12 months, its NAV total return has outperformed its MSCI Emerging Markets index benchmark by 10.2%. TEMIT has historically run a small cash balance, but in January 2017 announced it had entered into a new £150m credit facility; if fully drawn down, it would take gross gearing to c 7.0% of net assets.

12 months ending	Share price (%)	NAV (%)	MSCI Emerging Markets (%)	MSCI World (%)	FTSE All-Share (%)
31/03/13	10.0	11.5	7.7	18.4	16.8
31/03/14	(16.8)	(15.2)	(9.9)	9.0	8.8
31/03/15	6.9	9.6	13.2	19.7	6.6
31/03/16	(17.0)	(17.3)	(8.8)	0.3	(3.9)
31/03/17	48.3	49.0	35.2	32.7	22.0

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

Investment strategy: Bottom-up stock selection

Since 1 October 2015, Carlos Hardenberg has acted as TEMIT's lead manager. Drawing on a global team of over 50 investment professionals, he employs Templeton's five-stage investment process to construct a portfolio of emerging market equities that is diversified by sector and geography, with a bias to small and mid-cap companies. Since the change in manager, the number of holdings has roughly doubled from 46 to c 90. Meeting company managements is a key element of the investment process and includes an assessment of their corporate governance practices; while not activist, TEMIT may coordinate with other investment managers to encourage corporate changes.

Market outlook: EM valuations relatively attractive

Despite outperforming world equities in 2016 (a period of outsized returns for shareholders across the globe), emerging market equities remain at relatively attractive valuations. The MSCI Emerging Markets index has c 30% lower forward earnings and price-to-book multiples and a modestly higher dividend yield than the MSCI World index. In addition, relative economic growth forecasts favour emerging markets. For investors seeking exposure to emerging market equities, a fund with a disciplined, long-term, value-orientated approach may hold some appeal.

Valuation: Discount remains wider than average

TEMIT's current 14.2% share price discount to cum-income NAV compares to the averages of the last one, three, five and 10 years (range of 9.2% to 13.3%). There is scope for the discount to narrow if TEMIT's recent outperformance continues or investor appetite for emerging market equities increases, supported by the ongoing share repurchase programme. While managed for capital appreciation, TEMIT regularly pays an annual dividend; its current yield is 1.2%.

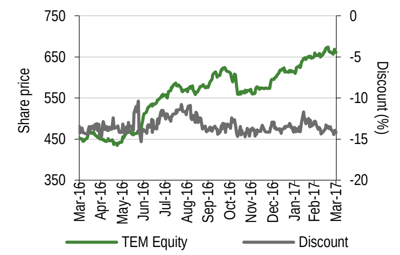
3 April 2017

Price	**661.5p**
Market cap	**£1,863m**
AUM	**£2,132m**
NAV*	764.4p
Discount to NAV	13.5%
NAV**	771.2p
Discount to NAV	14.2%

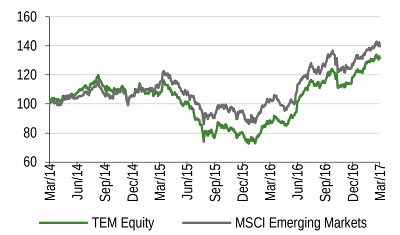
*Excluding income. **Including income. As at 30 March 2017.

Yield	1.2%
Ordinary shares in issue	281.6m
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	674.0p	435.0p
NAV** high/low	780.6p	503.4p

**Including income.

Gearing

Gross*	0.0%
Net cash*	0.1%

*As at 28 February 2017.

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Edison profile page

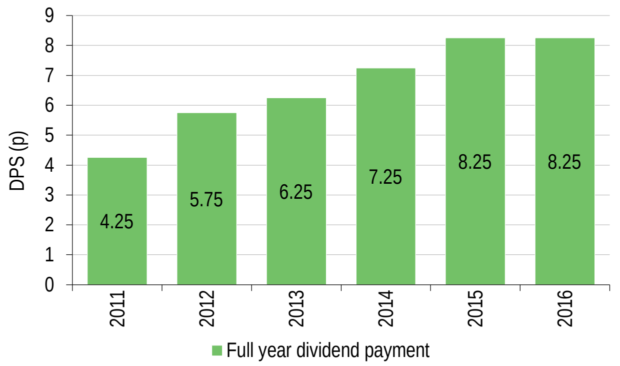
Templeton Emerging Markets Inv. Trust is a research client of Edison Investment Research Limited

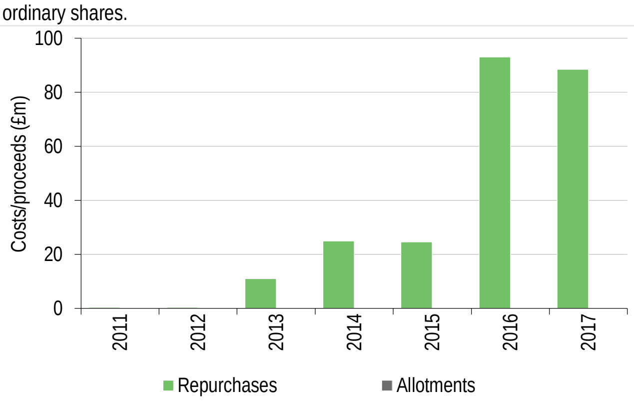
Exhibit 1: Trust at a glance

Investment objective and fund background	Recent developments
Launched in June 1989, Templeton Emerging Markets Investment Trust (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 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.	■ 31 January 2017: Announcement of £150m three-year, unsecured multicurrency revolving loan facility with the Bank of Nova Scotia. ■ 18 November 2016: Six months report to 30 September 2016 – NAV TR +29.6% versus benchmark TR +21.7%. Share price TR +29.1%. ■ 27 July 2016: Appointment of David Graham as non-executive director with effect from 1 September 2016. ■ 15 July 2016: Appointment of Simon Jeffreys as non-executive director.

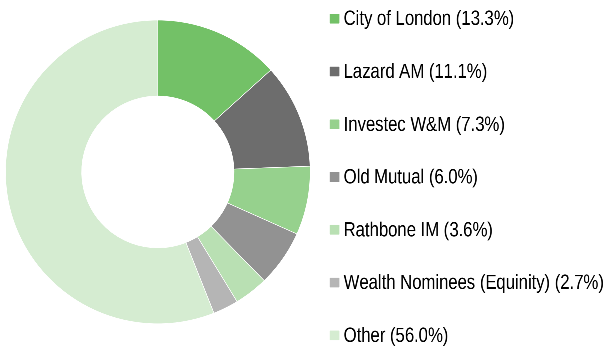
Forthcoming		Capital structure		Fund details	
AGM	July 2017	Ongoing charges	1.21%	Group	Templeton Asset Management
Final results	June 2017	Net cash	0.1%	Manager	Carlos Hardenberg
Year end	31 March	Annual mgmt fee	1.10% of net assets	Address	5 Morrison Street, Edinburgh,
Dividend paid	July	Performance fee	None		EH3 8BH, UK
Launch date	12 June 1989	Trust life	Indefinite	Phone	+44 (0)871 384 2505
Continuation vote	Five yearly (last in 2014)	Loan facilities	£150m	Website	www.temit.co.uk

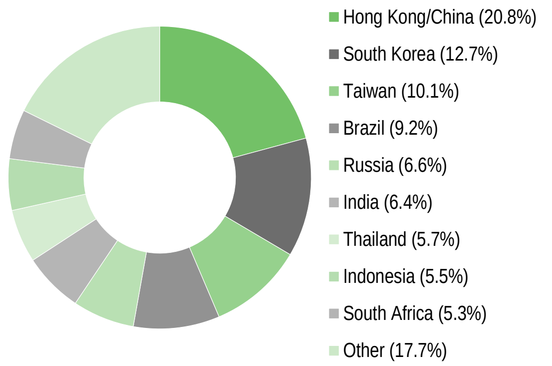
Dividend policy and history (financial years)	Share buyback policy and history (financial years)
Dividends are paid annually in July. The maintained dividend in FY16 follows five consecutive years of dividend increases.	TEMIT is authorised to repurchase up to 14.99% and allot up to 5% of its ordinary shares.





Shareholder base (as at 28 February 2017)	Portfolio exposure by geography (ex-cash as at 28 February 2017)





Top 10 holdings (as at 28 February 2017)

			Portfolio weight %	
Company	Country	Sector	28 February 2017	29 February 2016*
Brilliance China Automotive	Hong Kong/China	Consumer discretionary	6.9	5.2
Samsung Electronics	South Korea	Information technology	6.5	3.9
Taiwan Semiconductor Manufacturing	Taiwan	Information technology	4.5	3.6
Unilever	UK	Consumer staples	4.2	5.4
Naspers	South Africa	Consumer discretionary	4.1	N/A
Tencent Holdings	Hong Kong/China	Information technology	3.3	3.0
Compania de Minas Buenaventura (ADR)	Peru	Materials	3.2	N/A
Astra International	Indonesia	Consumer discretionary	2.9	3.5
Hon Hai Precision Industry	Taiwan	Information technology	2.8	N/A
Alibaba (ADR)	Hong Kong/China	Information technology	2.4	N/A
Top 10			40.8	36.9

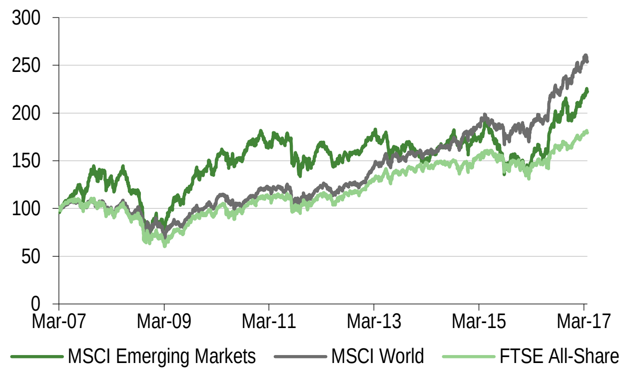
Source: Templeton Emerging Markets Investment Trust, Edison Investment Research, Morningstar. Note: *N/A where not in February 2016 top 10.

Market outlook: Potential for higher valuation

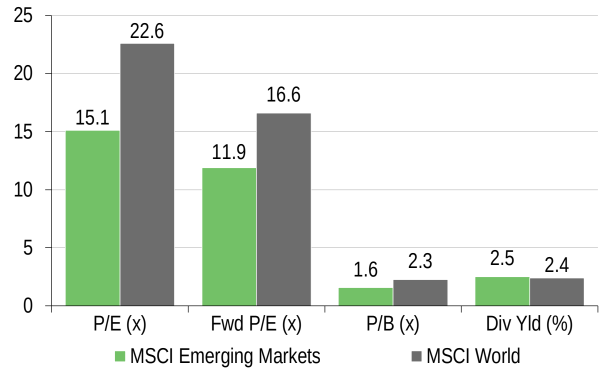
Exhibit 2 (left-hand side) shows the performance of emerging market versus world and UK equity indices over the last 10 years. Emerging market equities have lagged world equities due to the strength of the US stock market in recent years; however, in sterling terms, emerging markets outperformed global equities in 2016 by 4.1pp (33.1% versus 29.0% respectively). In its October 2016 World Economic Outlook, the International Monetary Fund maintained its above-average economic growth forecasts for emerging markets and developing economies versus world output (4.6% versus 3.4% respectively). Against a stronger economic background, as shown in Exhibit 2 (right-hand side), emerging market equities continue to be relatively attractively valued – trading at a c 30% discount on a forward P/E basis, on a lower price-to-book multiple and with a modestly higher dividend yield. For investors wanting exposure to emerging markets, a diversified fund with a disciplined, long-term value-orientated approach, may be of interest.

Exhibit 2: Market performance and valuation

Performance of indices in GBP (last 10 years)



Valuation metrics (as at 28 February 2017)



Source: Thomson Datastream, Edison Investment Research

Fund profile: Emerging markets specialist

TEMIT was launched in June 1989 and is quoted on the London and New Zealand stock exchanges – it was one of the first UK-listed funds focused on emerging markets. On 1 October 2015, Carlos Hardenberg succeeded Mark Mobius as TEMIT's lead manager; he continues to draw on Templeton's broad emerging markets group – a team of more than 50 investment professionals based in 20 offices across the world. Hardenberg aims to generate long-term capital growth, primarily via investment in emerging market equities or in companies listed elsewhere that generate a significant proportion of their revenues in emerging markets. TEMIT is benchmarked against the MSCI Emerging Markets index. Gearing of up to 10% is permitted – historically, the fund has run a small cash balance, but in January 2017, TEMIT announced a new £150m debt facility (see Capital structure and fees section on page 7).

The fund manager: Carlos Hardenberg

The manager's view: The future will be different to the past

The manager comments that when modelling a company's five-year earnings estimates, a consideration of the macro environment is the starting point, including a variety of inputs such as the outlooks for inflation, interest rates, exchange rates and potential regulatory changes. He suggests that companies themselves can provide the most reliable guide to local economic outlooks. Comparing the current macro backdrop to historical periods of stress, the manager believes that in aggregate, emerging market economies are stronger and more diverse, with the service sector making a greater contribution. He notes that Asia in particular has seen strong growth in the domestic economy. The biggest structural change has been the rise of value-added goods and services rather than low-end product offerings in industries such as IT components, software and consulting services. As a result, technology now represents a much larger part of the MSCI Emerging Markets index (c 25%). The manager notes that traditional industries such as cement and steel production, which benefitted from a ramp-up in infrastructure, will have to deal with higher costs going forward and as a result, expected to generate lower margins and earnings growth. He opines that the next five to 10 years will be very different from the last five to 10.

Hardenberg considers that Latin America is currently one of the most attractive emerging market areas; he suggests that product penetration is far behind other regions, which offers significant growth potential. The manager considers that emerging market currencies are trading on unusually large discounts versus hard currencies, having depreciated on a relative basis over the last couple of years, and in general emerging market currencies can be supported by their foreign currency reserves and more reasonable current account deficits.

Given the potential for changes in US trade policies, the manager is evaluating earnings sensitivities of potential and current portfolio holdings if tariffs were to be introduced. He notes that some Mexican companies have built their business models around trading with the US, which would suffer with an introduction of tariffs, although Mexican companies with large overseas operations that do not hedge their currency exposures, will benefit from a weak peso.

When discussing themes evident in Q4 earnings reports, Hardenberg comments that within the technology sector, compared to 12 months ago, business visibility is increasing. In general, the managements of technology companies are presenting a confident outlook for the balance of 2017 and into 2018. Many products are entering a replacement cycle and mobile phone manufacturers are adopting new technologies, such as dual and optical zoom cameras, new surface technology and software and increased memory. Industry demand for technology products has been very robust and the manager expects this trend to continue.

Asset allocation

Investment process: Five-stage investment process

TEMIT employs Templeton's five-stage investment process: identification of attractively valued companies; in-depth fundamental analysis; 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 and an assessment of the wider environment on a sector and country basis. Hardenberg is able to draw on the broad resources of Templeton's analyst team, which now includes five people with a dedicated technology focus. Following the change in manager in October 2015, the portfolio has been significantly restructured with the number of holdings broadly doubled from 46 to c 90. The manager comments that more than half of the top 40 positions are new additions since he took over as lead manager. He also notes that TEMIT now has stronger relationships with the managements of investee companies and there is more active engagement on a corporate governance basis, which may involve co-ordination with other key shareholders, to bring about corporate changes.

Current portfolio positioning

At end-February 2017, TEMIT's top 10 positions represented 40.8% of the portfolio, a small increase in concentration from 36.9% a year earlier. Brilliance China Automotive is a joint venture partner of BMW and remains the largest holding. The manager considers Brilliance to be a "rock-solid company", at the forefront of new battery technology, with a well-positioned product range expected to benefit from rising demand from China's expanding middle class. TEMIT is very close to Brilliance's management team, which operates in an open manner. The manager suggests that the company perfectly fits TEMIT's value and quantitative criteria.

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

	Portfolio end-February 2017	Portfolio end-February 2016	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Information technology	28.5	27.0	1.5	23.9	4.6	1.2
Consumer discretionary	21.9	18.0	3.9	10.3	11.6	2.1
Financials	19.4	20.1	(0.7)	24.5	(5.1)	0.8
Consumer staples	9.7	11.2	(1.5)	7.0	2.7	1.4
Energy	7.5	8.3	(0.8)	7.4	0.1	1.0
Materials	6.4	3.6	2.8	7.6	(1.2)	0.8
Industrials	3.4	4.3	(0.9)	5.8	(2.4)	0.6
Healthcare	1.6	1.7	(0.1)	2.5	(0.9)	0.7
Real estate*	0.6	0.0	0.6	2.6	(2.0)	0.2
Telecommunications	0.5	0.9	(0.4)	5.6	(5.1)	0.1
Utilities	0.4	0.0	0.4	2.9	(2.5)	0.1
Other net assets (cash)	0.1	4.9	(4.8)	0.0	0.1	N/A
	100.0	100.0		100.0		

Source: TEMIT, Edison Investment Research. Note: *Real estate was included in financials in February 2016.

After reorganising the portfolio starting in October 2015, the manager has made no dramatic changes on either a sector or geographic basis over the last 12 months. On a sector basis, the largest increases in exposure are consumer discretionary (+3.9pp) and materials (+2.8pp), with the largest decreases in cash (-4.8pp) and consumer staples (-1.5pp). On an individual country basis, the largest increase in exposure is Russia (+3.2pp) and the largest decrease is Pakistan (-2.2bps).

Exhibit 4: Portfolio geographic exposure (% unless stated)

	Portfolio end-February 2017	Portfolio end-February 2016	Change (pp)
Hong Kong/China	20.8	20.2	0.6
South Korea	12.7	11.6	1.1
Taiwan	10.1	8.5	1.6
Brazil	9.2	10.8	(1.6)
Russia	6.6	3.4	3.2
India	6.4	8.3	(1.9)
Thailand	5.7	5.7	0.0
Indonesia	5.5	5.8	(0.3)
South Africa	5.3	4.7	0.6
UK	4.2	5.4	(1.2)
Peru	3.2	1.8	1.4
Pakistan	2.4	4.6	(2.2)
Mexico	2.2	0.7	1.5
Other	5.7	8.5	(2.8)
	100.0	100.0	

Source: TEMIT, Edison Investment Research

South Korean company, Samsung is TEMIT's second largest position, it is a market leader in DRAM and NAND memory solutions and pricing for these products has been strong. Despite the recall and the eventual shelving of the Galaxy S7 Note mobile phone, Samsung's share price held up relatively well. The manager highlights Samsung as a high-profile example of an emerging-market company that is adopting better corporate governance practices and increasing shareholder distributions in the form of both dividends and share repurchases.

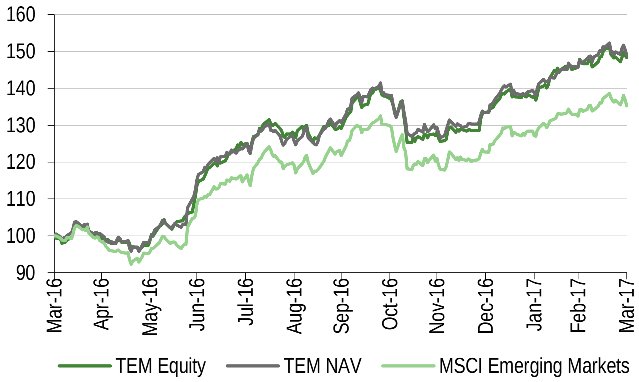
A relatively recent addition to TEMIT's portfolio is Catcher Technology, a Taiwanese company, which is a market leader in casings for smartphones. This business is highly capital intensive, but Catcher's capex is backed by customer contracts. The manager has had many discussions with Catcher's open management team and he is confident that the company can continue to prosper as the industry evolves to using new materials and technology for the manufacture of mobile phone cases. The stock is currently trading on a forward P/E ratio of 10.4x and has accelerating consensus earnings growth estimates (1.4% for 2017 and 9.2% for 2018).

Performance: Very strong one-year performance

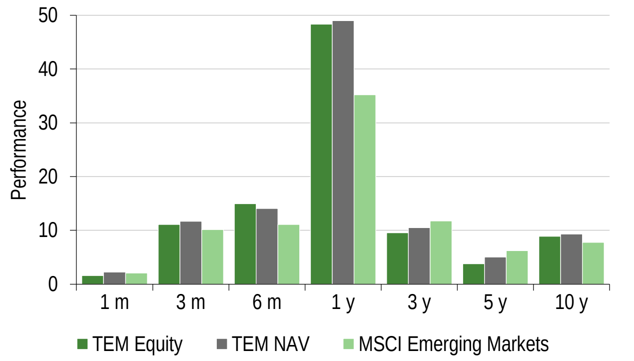
Exhibit 5 (right hand side) highlights the strength of TEMIT's absolute returns over one year, partly boosted by sterling weakness. TEMIT's share price and NAV one-year total returns of 48.3% and 49.0% respectively are significantly ahead of the 35.2% total return of the benchmark.

Exhibit 5: Investment trust performance to 31 March 2017

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.

TEMIT's NAV total return is ahead of the MSCI Emerging Markets index benchmark over one and 10 years, while lagging over three and five years. As a reference to UK shareholders, TEMIT has outperformed the FTSE All-Share index over one, three and 10 years, while its underperformance over five years reflects a relatively weak period for emerging markets in general.

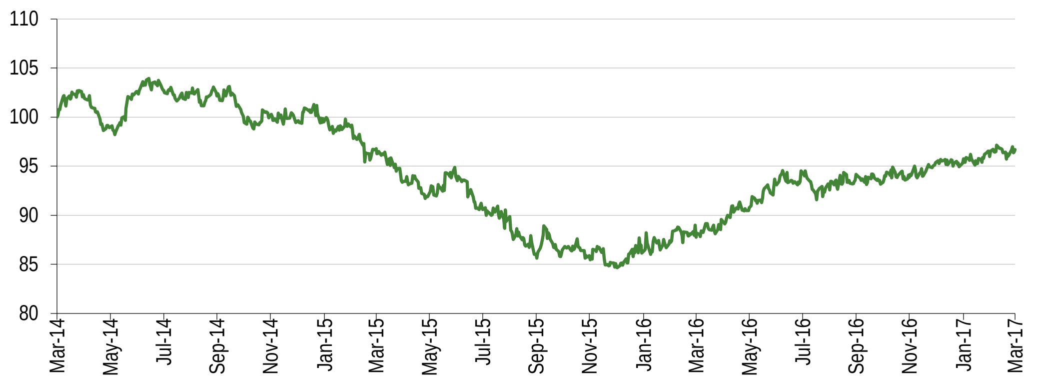
Exhibit 6: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to MSCI Emerging Markets	(0.4)	0.8	3.5	9.7	(5.8)	(11.0)	11.0
NAV relative to MSCI Emerging Markets	0.2	1.4	2.7	10.2	(3.3)	(5.7)	15.1
Price relative to MSCI World	1.0	5.5	1.9	11.8	(17.4)	(41.4)	(6.3)
NAV relative to MSCI World	1.6	6.1	1.1	12.3	(15.3)	(37.9)	(2.8)
Price relative to FTSE All-Share	0.4	6.8	6.4	21.6	5.4	(24.1)	35.4
NAV relative to FTSE All-Share	1.0	7.4	5.6	22.2	8.1	(19.5)	40.4

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-March 2017. Geometric calculation.

Exhibit 7 shows TEMIT's performance versus the benchmark over three years; the meaningful improvement since the new manager was appointed on 1 October 2015 is evident. Hardenberg comments that exposure to Brazil and a higher weighting in technology (across the capitalisation spectrum) were positive contributors to performance in 2016. At the stock level, positive contributors include Taiwanese companies Catcher Technology and Largan Precision.

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



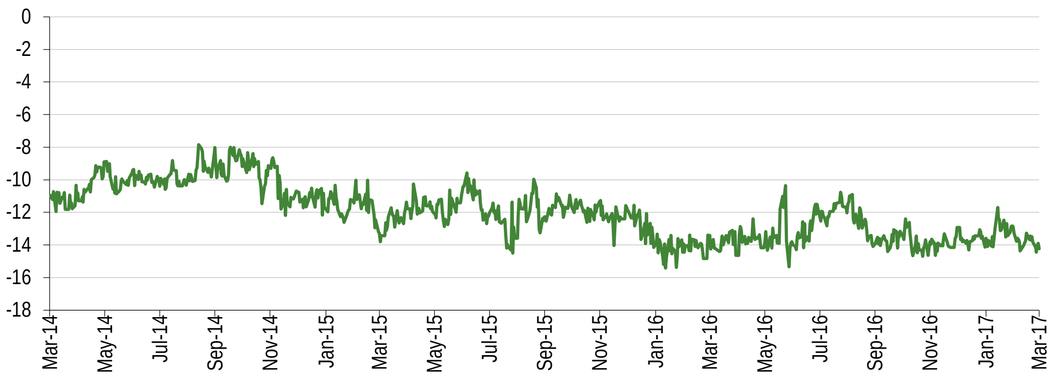
Source: Thomson Datastream, Edison Investment Research

Discount: No sustained narrowing of the discount

Despite significant returns to sterling-based emerging markets investors and TEMIT's very strong relative performance over the past 12 months, TEMIT's discount remains stubbornly wide, perhaps reflecting geopolitical uncertainties and generally higher risks associated with investing in emerging markets. Its current 14.2% share price discount to cum-income NAV is wider than the 13.3% average of the last 12 months (range of 10.4% to 15.3%) and also wider than the averages of the last three, five and 10 years of 12.0%, 10.8% and 9.2%, respectively.

There is scope for the discount to narrow if TEMIT's investment performance continues to improve or investor appetite for emerging market equities increases. TEMIT's board actively repurchases shares aiming to manage the discount. As shown in Exhibit 1, buybacks have continued in FY17, so far to 31 March, 16.3m shares (5.5% of shares in issue at the end of FY16) have been repurchased at an average cost of 541.6p.

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; there are currently 281.6m shares in issue. Gearing of up to 10% of net assets is permitted but has not been utilised in recent years. However, on 31 January 2017, TEMIT announced that it has entered into a £150m three-year unsecured multicurrency revolving loan facility (available in sterling, US dollars and renminbi) with the Bank of Nova Scotia, which the manager will use to add to portfolio holdings on weakness, taking advantage of market volatility. The maximum amount of renminbi that can be drawn down is the equivalent of £30m. If the whole facility was drawn down, based on the current net asset value, gross gearing would be c 7.0%.

TEMIT pays a management and administration fee to Templeton Asset Management of 1.10% of net assets – no performance fee is payable. Ongoing charges in H117 (ending 30 September 2016) were 1.21%, a modest reduction versus 1.22% in FY16.

Dividend policy and record

TEMIT pays an annual dividend in July. The FY16 dividend of 8.25p was held steady versus the prior year; it was partially paid out of revenue reserves as it was only 85% covered by income. Prior to FY16, TEMIT's annual dividend had been increased for five consecutive years, compounding at an annual rate of 17.1%. Based on the current share price TEMIT's dividend yield is 1.2%.

Peer group comparison

Exhibit 9 shows the members of the AIC Emerging Markets sector with market caps greater than £50m; TEMIT is the largest of the peers by a wide margin. Its NAV total return over one year is the highest in the group, leading the second ranked fund by 10.7pp. It is in line over three years and has lagged over five years, although TEMIT's NAV total return ranks second out of six funds over 10 years. Its discount is modestly wider than the weighted average and it has a lower than average ongoing charge. In keeping with its objective of long-term capital growth, TEMIT's dividend yield is lower than average.

Exhibit 9: Selected peer group as at 23 March 2017

% 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	Perform. fee	Net gearing	Dividend yield (%)
Templeton Emerging Markets IT	1,865.5	48.8	42.1	27.2	145.2	(12.9)	1.2	No	100	1.3
Aberdeen Emerging Markets	277.7	33.3	43.8	28.3	65.9	(15.7)	1.1	Yes	100	0.0
Aberdeen Frontier Markets IT	56.5	26.1	15.7	47.1		(8.1)	1.7	Yes	100	1.5
BlackRock Frontiers	251.9	35.7	42.4	99.9		3.6	1.4	Yes	115	3.4
Fundsmith Emerging Equities Trust	263.9	15.6				0.5	1.8	No	100	0.0
Genesis Emerging Markets Fund	860.4	32.9	41.3	36.4	137.6	(14.5)	1.4	No	100	0.0
JPMorgan Emerging Markets	946.5	35.8	55.2	49.6	130.4	(13.9)	1.2	No	100	1.2
JPMorgan Global Emerg Mkts Inc	370.6	37.7	41.8	45.2		(4.7)	1.4	No	106	3.9
Terra Capital	53.2	38.1	58.7	76.8	164.3	(19.6)	4.7	Yes	100	3.8
Utilico Emerging Markets	447.1	22.7	36.9	58.9	136.0	(11.4)	1.1	Yes	122	3.1
Group average	539.3	32.7	42.0	52.1	129.9	(9.7)	1.7		104	1.8
TEMIT rank in peer group	1	1	5	9	2	6	7		4	6

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

The board

There are currently eight directors on the TEMIT board; seven of whom are independent. Chairman Paul Manduca was appointed in August 2015 and assumed his current role in November of that year. Peter Harrison was appointed in November 2007, Christopher Brady in December 2007, Hamish Buchan in June 2008 and Beatrice Hollond in April 2014. During 2016, two new directors joined the board: Simon Jeffreys on 15 July and David Graham on 1 September. Jeffreys is a director at St James Place, SimCorp and Henderson International Income Investment Trust; he has a background in finance. Graham is a chartered accountant, with an investment management background. The remaining member of the board is Gregory Johnson; he was appointed in December 2007. As chairman and CEO of Franklin Resources, the parent company of the investment manager, he is considered non-independent. There is a succession plan in place, which means there will be further changes to the board over the next few years.

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