



Monthly perspective | April 12, 2018

## Campaigns: on your mark, get set, go?

### SUMMARY

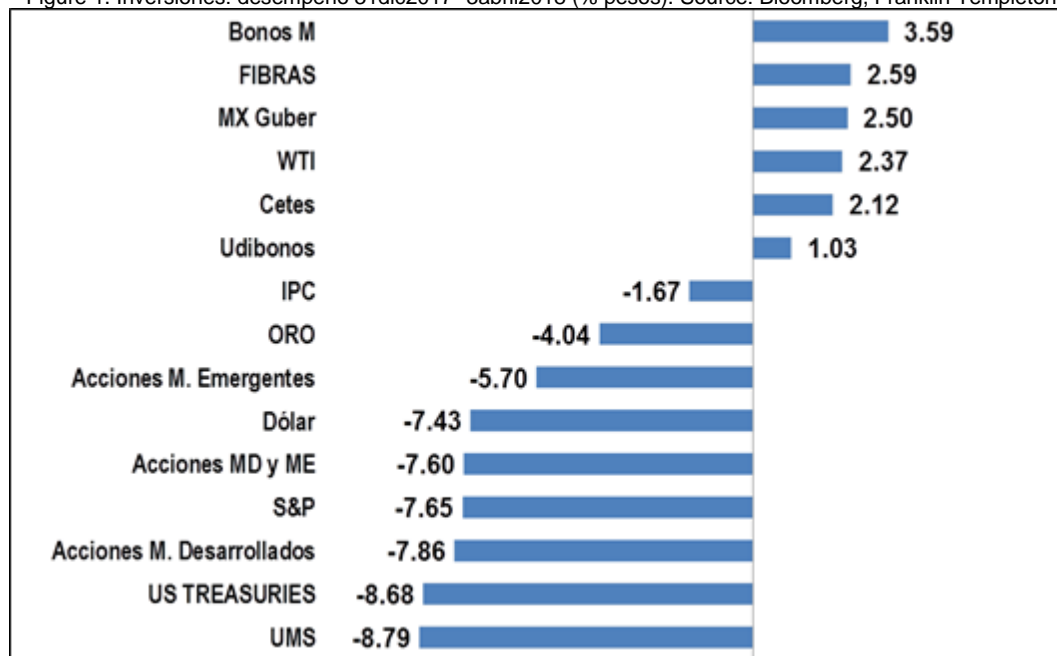
- Globally, fears of a trade war have combined with concerns about the economic cycle (inflation and rates), affecting stock markets.
- In Mexico, stocks were affected but the peso and REITs strengthened on hopes of a NAFTA resolution before July elections.
- Foreseeable global risks: failure of US pro-growth initiatives, trade wars, Europe, geopolitics, monetary policy, Bitcoin.
- In Mexico, main local risks are NAFTA renegotiation before elections and a negative result in July elections.
- Investment scenarios for 2018 no change, with probabilities: positive (20%), negative (40%), middle (40%).
- Overweight ILS duration 1 to 3 years, underweight stocks and REITs.

“The media, the polls and our legislatures fortunately have short attention spans” – John Gutfreund

### Trade wars and election campaigns

Trump's protectionist measures, his extraordinary personnel rotation, and the Facebook scandal roiled stock markets, including Mexico. The peso strengthened against the US\$, despite the official beginning of the campaign for the July elections, and REITs rose, owing to hopes of a NAFTA resolution (Figure 1).

Figure 1. Inversiones: desempeño 31 dic 2017 - 3 abril 2018 (% pesos). Source: Bloomberg, Franklin Templeton



## POLITICS

### USA

#### Trade policy

After his announcement in March of tariffs on steel and aluminum, effective May 1 2018, Trump announced tariffs up to 25% on imports from China worth up to US\$60bn., with no clarity on which imports. At the beginning of April, China responded with tariffs from 15% to 25% on 128 American products including fruit wine and pork. The US published a preliminary list of more than 1,300 products that could be affected, including flat screens, weapons, satellite, medical equipment, and batteries: in contrast to steel and aluminum, these measures are mainly covered by WTO rules. China responded with measures affecting US exports valued at US\$50bn. annually, focusing on soya (the main US export to China), autos, chemicals and planes, all products from regions with Republican majorities, a clear attempt to influence legislators.

Calling these tariffs “unjust”, Trump promised to look at new protectionist measures. Apparently China is considering yen depreciation as a tool in a trade war against the US. Subsequently both countries claimed to be seeking to avoid a full-scale trade war, and there were words of reassurance from Trump’s economic team, currently headed by a new Chief Economic Advisor, Lawrence Kudlow, who replaced Gary Cohn, who had resigned on March 6 as protest against protectionism.

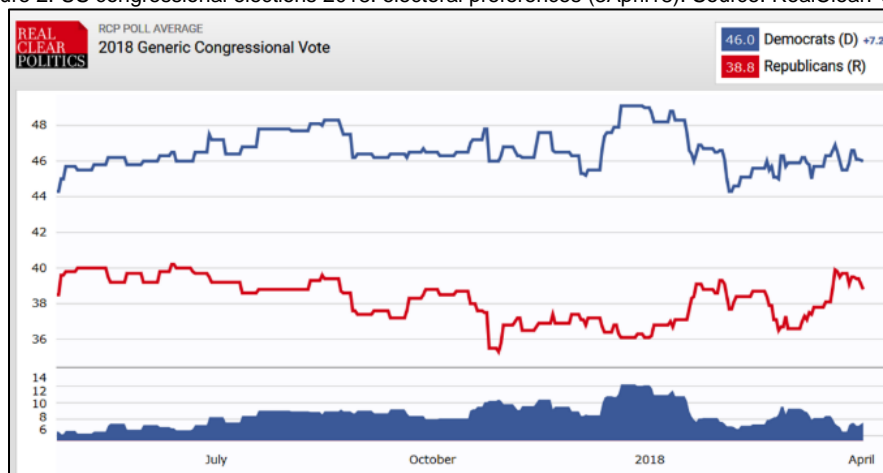
#### Personnel turnover

Rex Tillerson, Secretary of State, and retired general H. R. McMaster, National Security Adviser, were fired by Trump in March. They were replaced by Mike Pompeo, Director of the CIA, and John Bolton, previously US ambassador to the UN (under George W. Bush). Speculation is that the next to go will be Attorney General Jeff Sessions, Defense Secretary James Mattis, and chief of staff John Kelly. Sessions’ departure would be a response to the increasingly aggressive investigation of Trump, his family and team, and those of Mattis and Kelly to their inability to adapt to Trump’s management style.

#### Politics

For congressional elections, due November 6 2018, according to polls, Republics still lag, although it is unclear whether they will lose their majority in both Senate and House (Figure 2).

Figure 2. US congressional elections 2018: electoral preferences (3April18). Source: RealClearPolitics



## GLOBAL

### North Korea

At the beginning of March Trump accepted an invitation to meet with Kim Jong Un, President of North Korea, with South Korean participation. In response, at the end of March Kim left his country for the first time since 2011, when he became President, to visit Chinese leader Xi Jinping. This simultaneous approach to the US and China is a tactic the North Korean regime has used to survive as it advances its nuclear program.

## Russia

In March, Vladimir Putin, after 18 years in power, was reelected President, until 2024, with a majority of 77% and voter participation of 70%. The US announced its most severe sanctions yet against Russian companies and oligarchs for backing atrocities by the Syrian government against its citizens. In April, Trump announced the possibility of airstrikes against the Syria government, explicitly criticizing Russia.

## Brazil and Peru

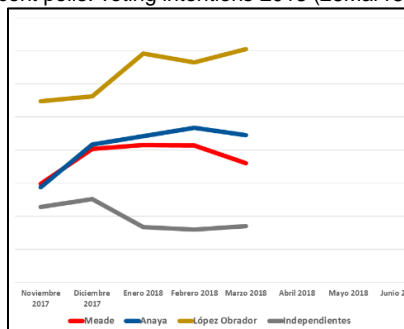
In Brazil, Lula, candidate to return to the presidency in 2018 elections, was returned to jail with a 12 years sentence, as his appeal against corruption charges failed. In Peru, Congress accepted the resignation of President Pedro Pablo Kuczynski owing to charges against his lawyer and various ministers of buying opposition votes in exchange for public works.

## MEXICO

### 2018 elections

At the end of March, AMLO was in first place in the opinion polls (Figure 3). This big lead is due to his message (rejection of corruption associated with traditional parties, rejection of education energy and telecoms reforms and proposed cancellation of the new Mexico City airport Project (NAICM)), and his effective use of social media since the beginning of the Peña administration. Combined with an important change in tone, towards moderation compared with previous campaigns, AMLO seems to attract the population outside urban areas and millennials (less than 30 years old) who comprise 29% of the electorate, and who have not experienced the political and economic instability caused by the old PRI in the 1970s (Presidents Echeverría and López Portillo), with whom many older generations identify him.

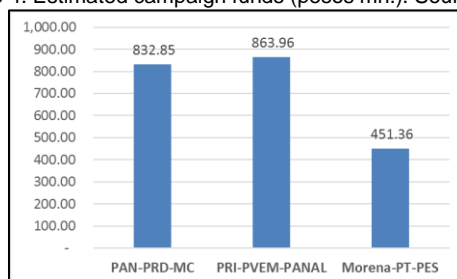
Figure 3. Average of most recent polls: voting intentions 2018 (28Mar18). Source: polling organizations



During the “precampaign”, Meade looked to distinguish himself from his predecessors and other candidates by presenting a “7 of 7” declaration: in addition to the “3 of 3” declaration, of assets, conflict of interest and taxes, he presented certificates from the property registry, an accountant’s opinion, a tax report, and notarized certificate proof of the reality of his documentation. After Trump announced the deployment of 2500 to 3000 National Guard troops along the Mexican frontier, President Peña Nieto replied with a speech approved by all candidates, improving Meade’s popularity.

On April 1, the official campaigns began for President, 8 state governors (Chiapas, Guanajuato, Jalisco, Morelos, Puebla, Tabasco, Veracruz and Yucatán), Mexico City Mayor, 500 deputies 128 senators and local elections in 30 states: a total of 3,326 electoral posts. For the first time, there are two independent presidential candidates, Margarita Zavala and Jaime Rodríguez (“El Bronco”). There are important differences with the precampaign. First each party can officially spend campaign funds: the coalitions comprising of PRI-PVEM-PANAL (Meade) and PAN-PRD-MC (Anaya) have more money than Morena-PT-PS (AMLO) (Figure 4).

Figure 4. Estimated campaign funds (pesos mn.). Source: INE



Second, PRI and PAN can make use of their greater coverage and experience than Morena, which was founded in as recently as 2014. Third, there will be three debates, in April, Mayo and June (Figure 5). Meade and Anaya are considered better debaters than AMLO (Figure 5).

Figure 5. Presidential debates 2018. Source: INE

DEBATE	THEME	TOPICS
Mexico City 22-Apr	Politics and government	Fighting corruption and impunity Public security and violence
Palacio de Minería		Democracy, pluralism and rights of vulnerable groups
Tijuana 20-May	Mexico in the world	Foreign trade and investment
Universidad		Frontier security and fighting
Autonomoa de Baja California, campus Tijuana		Immigrants rights
Mérida 12-Jun	Economics and development	Economic growth, poverty and Education, science and technology
Museo del mundo Maya		Sustainable development and climate change

The main issue is whether the combination of greater expenditure, coverage and organization, ability in debates, and better use of social media to convey a more conservative and less radical message will be sufficient for the PRI and/or PAN-PRD coalition to catch up with AMLO and Morena. Among many scenarios are: use of tactical voting, that when the campaigns end on June 27, undecided voters (estimated at 20%), backers of independent candidates (4-6%) and backers of the coalition in third place in the polls, combine with the second place coalition against AMLO and Morena; or a split vote between the presidency, with AMLO winning it, and Senate and Congress won by other parties.

## NAFTA negotiations

Negotiations have advanced owing to the attitude of the US, which apparently does not want to negotiate simultaneously on two fronts, with Mexico after the elections, and China. At the beginning of April, Ildefonso Guajardo suggested an 80% probability of definitive progress by the beginning of May.

## ECONOMY GLOBAL

Global growth is expected to grow in 2018, but a slowdown is expected for 2019 mainly in developed economies (Figure 6).

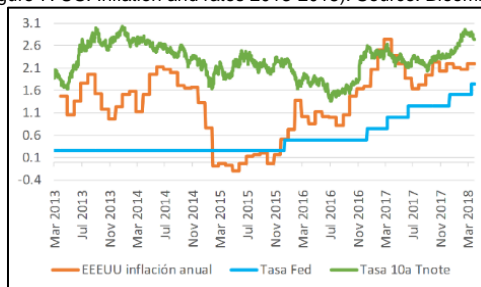
Figure 6. Developed and emerging economies: estimated growth 2017- 2019 (April2018) Source: Bloomberg

Developed markets				Emerging markets			
Growth(%)	2019 E	2018 E	2017 E	Growth(%)	2019 E	2018 E	2017 E
World	3.70	3.80	3.60	World	3.70	3.80	3.60
Developed	2.14	2.46	2.36	Emerging	5.01	4.94	4.57
US	2.40	2.80	2.30	China	6.20	6.50	6.90
Euro Area	2.00	2.40	2.50	India	7.40	6.70	6.30
Japan	1.00	1.30	1.60	Rusia	1.80	1.85	1.50
Britain	1.50	1.50	1.70	Brasil	2.63	2.55	1.00
Australia	2.80	2.70	2.30	México	2.30	2.20	2.10
Canada	1.80	2.15	2.95	Corea del sur	2.80	3.00	3.20
Germany	1.90	2.50	2.50	Indonesia	4.00	5.30	5.10
France	1.80	2.10	1.90	Turquia	4.00	4.10	6.80

## FED

As expected, the FED raised its benchmark rate from 1.50% to 1.75% taking account of growth and employment dynamics. Higher inflation is expected owing to wage increases caused by employment at record lows in 35 years, increase in voluntary retirement, and vacancies in small companies at record levels since 1974 (Figure 7).

Figure 7. US: Inflation and rates 2013-2018). Source: Bloomberg



## BITCOIN

With considerable volatility, Bitcoin has fallen below US\$7,000, and with no serious effect either on other markets or the economy. It is conceivable that the systemic danger is diminishing.

Figure 8. Bitcoin: prices (US\$ - Apr2018). Source: Bloomberg



## MEXICO

### Economic policy pre-criteria

The Treasury Ministry (SHCP) presented to Congress its economic policy pre-criteria (pre-Criterios de Política Macroeconómica) for 2018 and 2019. Growth is estimated between 2-3% (2018) and 2.5-3.5% (2019), inflation 3.5 and 3, real interest rate 4% and 4.2%, average exchange rate to US\$ of 18.4 pesos. Public sector financial requirements are estimated at 2.5% of GDP, maintaining its downward trend (Figure 9).

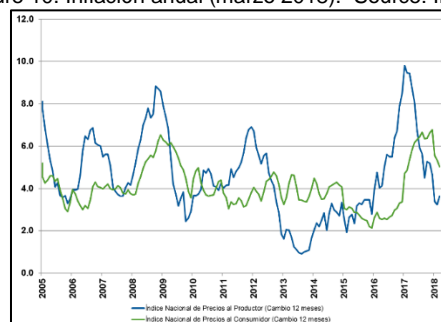
Figure 9. Economic policy pre-criteria Source: SHCP

MARCO MACROECONÓMICO, 2018-2019 <sup>en</sup>		
	2018	2019
<b>Producto Interno Bruto</b>		
Crecimiento % real (Rango)	2.0 - 3.0	2.5 - 3.5
Nominal (miles de millones de pesos)*	23,391.1	24,879.9
Deflactor del PIB	4.8	3.3
<b>Inflación</b>		
Dic. / dic.	3.5	3.0
<b>Tipo de cambio nominal</b>		
Fin de periodo	18.4	18.4
Promedio	18.4	18.4
<b>Tasa de interés (CETES 28 días)</b>		
Nominal fin de periodo, %	7.5	6.8
Nominal promedio, %	7.5	7.1
Real acumulada, %	4.0	4.2
<b>Cuenta Corriente</b>		
Millones de dólares	-24,288	-25,826
% del PIB	-1.9	-1.9
<b>Variables de apoyo:</b>		
<b>Balance fiscal, % del PIB</b>		
Con inversión	-2.0	-2.0
Sin inversión	0.0	0.0
<b>PIB EE.UU. (Var. anual)</b>		
Crecimiento % real	2.8	2.4
<b>Producción Industrial EE. UU.</b>		
Crecimiento % real	3.3	2.4
<b>Inflación EE. UU.</b>		
Promedio	2.3	2.2
<b>Tasa de interés internacional</b>		
Libor 3 meses (promedio)	2.1	2.7
FED Funds Rate (promedio)	1.7	2.3
<b>Petróleo (canasta mexicana)</b>		
Precio promedio (dls. / barril)	53	51
Plataforma de producción promedio (mbd)	1,983	2,035
Plataforma de exportación promedio (mbd)	888	911

## Inflation

In March, consumer inflation fell from 5.34% to 5.04%, and producer inflation rose from 3.24% to 3.64% (Figure 10).

Figure 10. Inflación anual (marzo 2018). Source: INEGI.



## RISKS AND SCENARIOS FOR 2018

Considering foreseeable risks, we present 3 scenarios for 2018, where the objective is Mexican economic growth. In the positive scenario, all risks turn out positive for Mexican growth, in the negative, all turn out negative, and in the middle, they vary different (in nature, intensity and/or duration).

### RISKS

#### Global

- EEUU: Trump progrowth initiatives, trade wars
- North America: NAFTA renegotiation
- Europe: Brexit, Catalonia and elections (Italy)
- Geopolitics: Middle East, Russia, China, North Korea
- Global slowdown, monetary policy
- Bitcoin

#### Mexican

- Elections 2018
- Security
- Corruption
- Oil price
- Debt increase: credit rating

### SCENARIOS

#### Positive (20%)

- US: tax reduction, deregulation and infrastructure investment, absence of trade wars.
- NAFTA renegotiation "win-win".
- Europe, China, Russia, Korea and Middle East: risks do not materialize.
- Global synchronous growth, successful monetary policy.
- Bitcoin crash does not affect economy.
- Mexico: corruption and security risks contained, positive elections.

#### Negative (40%)

- US: progrowth policies fail, trade wars break out.
- NAFTA renegotiation fails.
- Europe (UK and EU) disintegrates, risks in China, Russia, Korea and Russia materialize.
- Global slowdown due to politics, economic dynamics, or monetary policy.
- Bitcoin crash affects economy.
- Mexico: corruption and insecurity increase, negative elections.

#### Middle (40%)

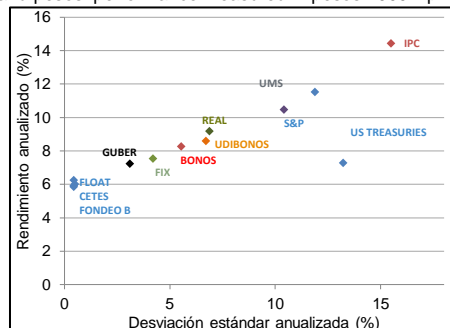
- US progrowth measures partially successful, mixed trade measures.
- TLC renegotiation partially positive.
- Europe, China, Russia, Korea and Middle East: risk materialize partially.
- Global growth continues, less synchronized than 2017 and monetary policy partially successful.
- Bitcoin crash partially affects economy.
- Mexico: corruption and security partially contained, uncertain elections.

## MARKETS

### Investments in US\$ and pesos: comparative performance

Despite peso depreciation, long term (2000-2018) peso denominated investments have outperformed US investments denominated in US\$, converted to pesos (Figure 12).

Figure 12. Investments in US\$ and pesos: performance measured in pesos 2000-Apr2018. Source: Franklin Templeton



## US\$ and peso

The peso has recovered owing to NAFTA optimism (Figures 12 and 13). One possibility is that markets are dividing the period into two stages, NAFTA renegotiation, which looks positive, and the elections, which seem distant and uncertain. Another possibility is that they do not think the election result will be negative either because AMLO will do nothing negative, or because he will not win.

Figure 13. US\$ index and peso 2005-Apr2018. Source: Bloomberg

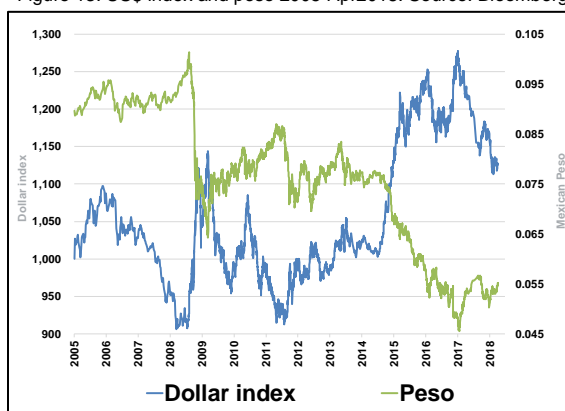
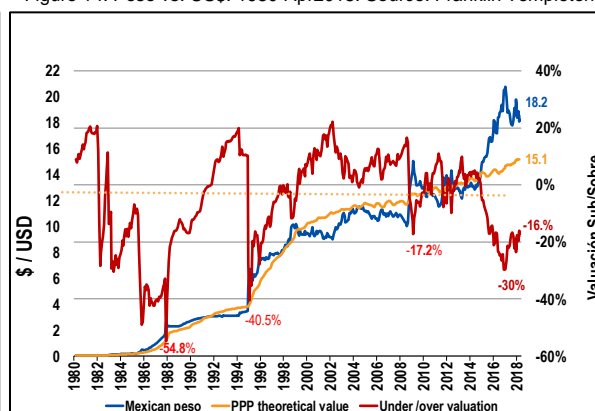


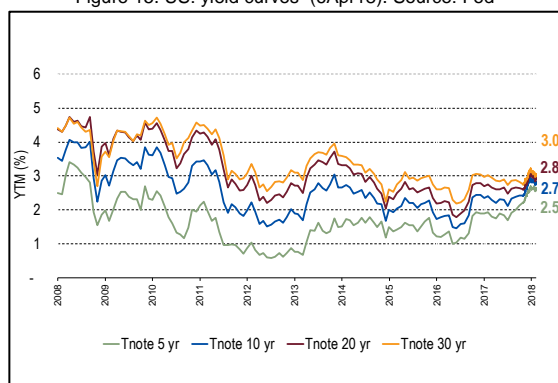
Figure 14. Peso vs. US\$: 1980-Apr2018. Source: Franklin Templeton



## Debt

US rates fell during the month at the middle and short end, while short rates rose, flattening out the curve even more (Figure 15). The Fed has hinted that inflation is increasing, and that this could imply a faster rate of normalization of monetary policy. In March, the Fed reference rate rose from 1.50% to 1.75%.

Figure 15. US: yield curves (6Apr18). Source: Fed



The market still expects rates to rise in practically all developed economies, with mixed movements in emerging economies (Figure 16).

Figure 16. Developed and emerging economies: estimated nominal 10y rates end 2018 (6Apr2018). Source: Bloomberg, Franklin Templeton

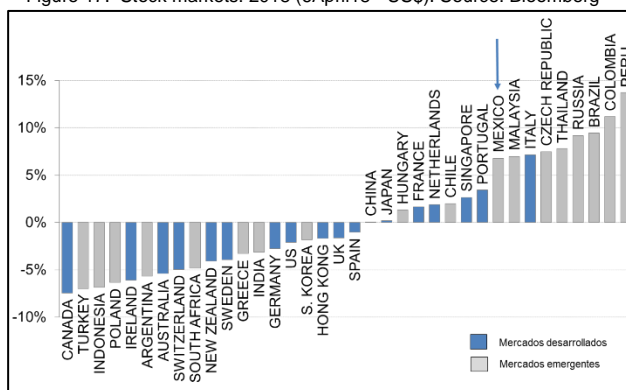
Developed				Emerging			
local 10y yields (%)				local 10y yields (%)			
	4Q18e	Actual	Aumento (bps)		4Q18e	Actual	Aumento (bps)
US	3.16	2.84	32	China	3.84	3.72	12
Euro Area	0.99	0.52	48	India	7.49	7.47	2
Japan	0.09	0.03	6	Rusia	6.80	7.17	(37)
Britain	1.83	1.46	37	Brasil	10.25	9.80	45
Australia	3.07	2.72	35	México	7.70	7.34	36
Canada	2.66	2.28	38	Corea del sur	2.76	2.58	18
Germany	0.99	0.52	48	Indonesia	6.63	6.59	4
France	1.27	0.75	52	Turquia	11.77	13.02	(125)



## Stocks

The year 2018 began well, but in addition to worries about the economic cycle there were fears of a trade war and this was compounded by worries about tech stocks. The Facebook scandal, for permitting unauthorized use of private information, was deepened by Trump's attacks on Amazon, alleging that it evaded taxes and caused losses to the US postal service. The underlying politics is that Jeff Bezos, Amazon CEO and founder is owner of *The Washington Post*, which is not pro-Trump. Markets fear more regulation of the so-called FAANGs (Facebook, Amazon, Apple, Netflix, Google) will limit the sector's dynamism. The Mexican market followed global markets but was helped in dollar performance, by peso appreciation (Figure 17).

Figure 17. Stock markets: 2018 (6April18 - US\$). Source: Bloomberg



In Mexico and US, markets have been more volatile than 2017 but this is normal long term (Figures 18 and 19).

Figure 18. Mexico: stocks (IRT pesos). 1Jan17-06April18. Source: Bloomberg

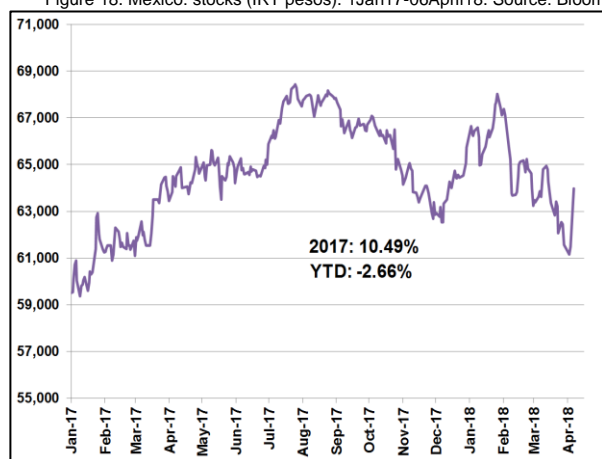
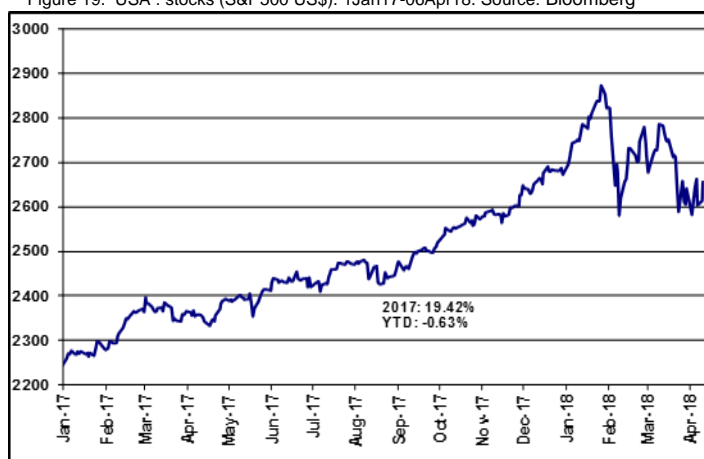


Figure 19. USA : stocks (S&P500 US\$). 1Jan17-06April18. Source: Bloomberg



## REITs

Due to novelty, inflation protection, and high dividends, REITs (Fibras) have outperformed stocks since 2011. Since Trump's election in November 2016, they have been hit by increased NAFTA uncertainty, political uncertainty in Mexico and recently by fears of inflation and a trade war (Figures 19 and 20). They have recently recovered owing to improved NAFTA prospects.

Figure 20. REITs vs. Mexican stocks (IRT) Mar2011-6Apr18 (base 100 MXN\$). Source: Bloomberg

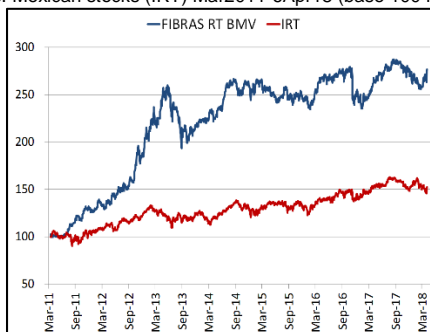




Figure 20. REITs: valuation and dividends (6Apr2018). Source: Franklin Templeton

	Mcap (M) (MXN)	Calendarized						
		2013	2014	2015	2016	2017	2018	2019
FUNO11 MM	119,692	6.0%	6.6%	6.5%	6.8%	6.8%	7.6%	8.1%
DANHOS13 MM	43,289	5.8%	6.5%	7.0%	5.8%	7.7%	8.2%	7.8%
TERRA13 MM	23,849	6.4%	6.5%	6.9%	8.1%	8.4%	8.6%	8.5%
FIBRAPL MM	22,629	3.3%	4.6%	5.8%	6.3%	6.1%	6.3%	6.1%
FIBRAMQ MM	16,365	8.2%	7.5%	8.8%	7.5%	7.6%	7.8%	8.1%
FIHO12	9,908	7.3%	7.2%	7.9%	7.4%	9.2%	11.0%	10.0%
FHIPO	8,085		11.6%	11.7%	12.0%	12.5%	13.0%	12.7%
FMTY14 MM	7,808			7.8%		8.7%	8.8%	
FINN13 MM	5,628	6.2%	5.7%	7.0%	7.8%	7.9%	8.0%	8.7%
FSHOP13 MM	5,594	8.4%	9.5%	10.2%	9.3%	9.2%	8.9%	8.0%

The FIBRA E of the new Mexico City airport (“FNAIM”) issued \$30bn. pesos mainly in Mexico, with an estimated 10% yield, and first distributions scheduled for 2021. Expected new issues, before July elections include ones specializing in hotels (FSTAY), universities, sharing economy, and (FIBRAS E) prisons, hydraulic projects in Southern Mexico.

### Conclusion

The risk of external shocks (inflation and trade wars) combined with local risks (NAFTA and elections) could offer windows of opportunity in financial markets. Overweight ILS for 1-3 year terms, underweight stocks and REITS.

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**April 12, 2018**

**Main financial indicators: monthly at March 28, 2018**

During March, In Mexico, the IPC fell 2.77%. Nominal and real rates fell over all terms. The US\$ fell 2.99% vs. the peso. In the US, the DJ, S&P500 and Nasdaq fell. Nominal and real rates fell, except Tbills. In the Banxico business climate poll, optimism rose to 16% (13% previous), no change fell to 50% (70%), and pessimism rose to 34% (17%).

Mexico					
Stock market and oil					
	28-Mar-18	28-Feb-18	Month	YTD	2017
IPC	46,124.85	47,437.93	-2.77%	-6.54%	8.13%
Local currency (USD/MXN)	18.27	18.83	-2.99%	-7.08%	-4.64%
Mexican oil mix (USD/bl)	56.9	55.59	2.36%	1.26%	21.36%
Nominal rates					
	28-Mar-18	28-Feb-18	Month	YTD	2017
CETES 28	7.56%	7.59%	-3 bps	24 bps	148 bps
CETES 360	7.59%	7.67%	-8 bps	13 bps	103 bps
M5	7.20%	7.52%	-32 bps	-39 bps	38 bps
M10	7.33%	7.64%	-31 bps	-32 bps	15 bps
M30	7.63%	7.89%	-26 bps	-15 bps	-4 bps
Real rates					
	28-Mar-18	28-Feb-18	Month	YTD	2017
UDIBONO 10	3.63%	3.67%	-4 bps	13 bps	45 bps
UDIBONO 30	3.86%	3.88%	-2 bps	16 bps	-9 bps
Commodities					
	28-Mar-18	28-Feb-18	Month	YTD	2017
Gold	1,325.01	1,318.31	0.51%	1.70%	12.48%
WTI (USD/bl)	56.9	55.59	2.36%	1.26%	4.60%
UMS					
	28-Mar-18	28-Feb-18	Month	YTD	2017
UMS 10 years	4.15%	4.21%	-7 bps	52 bps	-64 bps
UMS 20 years	5.01%	4.92%	8 bps	48 bps	-74 bps
UMS 30 years	4.96%	4.96%	0 bps	32 bps	-62 bps
Stock markets (US\$)					
	28-Mar-18	28-Feb-18	Month	YTD	2017
MSCI Developed	8,290.63	8,549.70	-3.03%	-2.08%	23.07%
MSCI Emerging	2,539.39	2,606.49	-2.57%	0.70%	37.75%
MSCI Mexico	9,461.02	9,416.07	0.48%	0.65%	16.27%
MSCI Brazil	6,976.43	7,257.43	-3.87%	10.12%	24.48%

US					
Stock market					
	28-Mar-18	28-Feb-18	Month	YTD	2017
DJ	23,848.42	25,029.20	-4.72%	-3.52%	25.08%
S&P	2,605.00	2,713.83	-4.01%	-2.57%	19.42%
Nasdaq	6,949.23	7,273.01	-4.45%	0.66%	28.24%
Nominal rates					
	28-Mar-18	28-Feb-18	Month	YTD	2017
Tbill 90	1.73%	1.65%	8 bps	46 bps	76 bps
Tnote 5	2.59%	2.65%	-6 bps	45 bps	21 bps
Tnote 10	2.77%	2.87%	-10 bps	35 bps	-3 bps
Tbond 30	3.01%	3.13%	-12 bps	18 bps	-23 bps
Real rates					
	28-Mar-18	28-Feb-18	Month	YTD	2017
Tip 5	0.68%	0.61%	7 bps	42 bps	17 bps
Tip 10	0.72%	0.75%	-3 bps	25 bps	-3 bps
Tip 30	0.94%	0.99%	-5 bps	22 bps	-27 bps

Bank of Mexico survey		
Indicator	2018	2018 anterior
PIB	2.21%	2.28%
Inflation	4.07%	4.09%
Cetes 28	7.47%	7.42%
Local currency	18.84	18.86
Business conditions		
	28-Mar-18	28-Feb-18
Optimism	16%	13%
No change	50%	70%
Pessimism	34%	17%

Source: Bloomberg, Banco de Mexico

**IMPORTANT LEGAL INFORMATION**

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