


# Will 2020 be better?

## Portfolio Management team




**Timothy Heyman, CBE**  
President



**Ramsé Gutierrez, CFA**  
VP / Portfolio manager



**Luis Gonzalí, CFA**  
Portfolio manager



**Jorge Marmolejo, CFA**  
Portfolio manager



**Nadia Montes de Oca, CFA**  
Portfolio Manager

## Franklin Templeton Advisory Services Mexico (FTSAM)\*

- Established 2013.
- Subsidiary of Franklin Templeton Investments.
- Investment solutions for our clients taking into account their needs and the global and local environment.
- Portfolio management team with more than 20 years' experience.
- Pioneers in Mexican investments.

## Franklin Templeton Culture and Values

- Put clients first.
- Build relationships.
- Achieve quality results.
- Work with integrity.

## SUMMARY

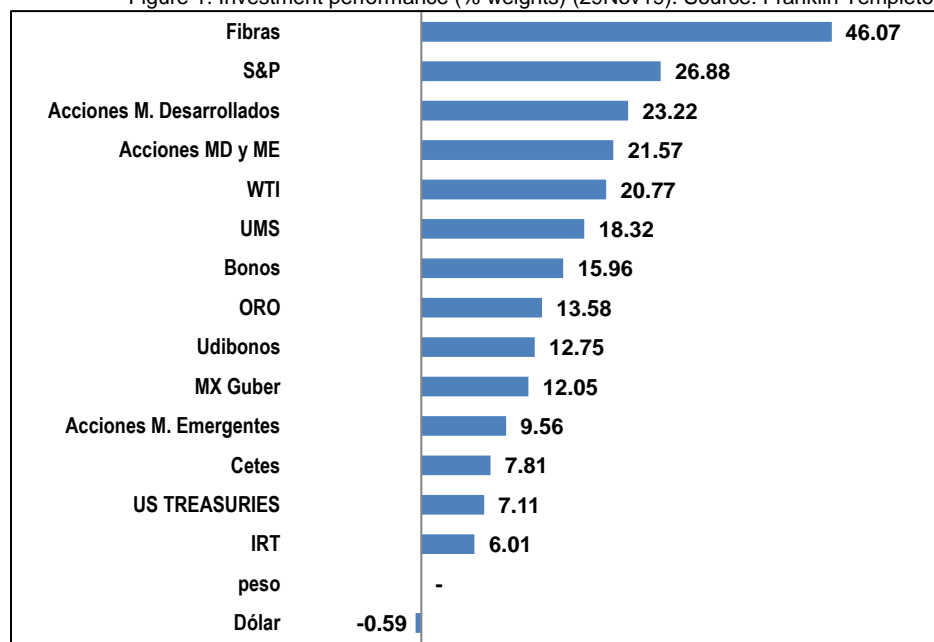
- Global. Dispute with China unresolved. Trump impeachment possible. Brexit subject to elections in December. Rate cuts paused. Markets still strong.
- Mexico. 2019 bad year for economy and security. USMCA difficult for 2019. AMLO popularity falling. Short term rates to fall. Markets still firm.
- Global risks: abrupt slowdown, trade wars, geopolitics, Brexit/Europe, monetary policy, emerging markets.
- Local risks: dysfunctional government, TMEC non-ratification, loss of investment grade, capital flight.
- Investment scenarios with probabilities: positive (10%), negative (50%), middle (40%).
- For portfolios in pesos, overweight liquidity and ILS debt with duration 1 to 3 years, underweight stocks, benchmark weight REITs (Fibras).

"You will only hit rock bottom when you stop digging". Anon.

## Global slow down and local

November was a positive month for global markets, despite the trade uncertainty and Brexit process. In Mexico, markets were negative with long-term rates rising and stock declines, but REITs (Fibras) rose. After revisions, indicators show a recession from 4Q18 to 2Q19. A balanced budget and an infrastructure program were approved to revive the economy. Lower Banxico rates are expected. If the global and local outlook does not improve, an effect on markets in 2020 seems inevitable.

Figure 1. Investment performance (% weights) (29Nov19). Source: Franklin Templeton ("FT")



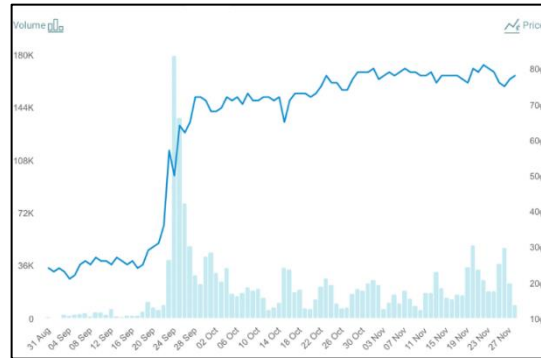
## POLITICS

## US

## Trump impeachment inquiry

After 10 days of investigative hearings for impeachment, polls are unchanged about a Trump trial or removal. Meanwhile, Trump has not declared whether he will agree to participate in the hearings and the intelligence committee report is expected to be filed in the coming weeks. Should the judiciary decide to impeach, it would start in the Senate in January 2020, which still seems highly likely according to betting polls (Figure 2). But given the Republican majority in the Senate, Trump's removal is unlikely.

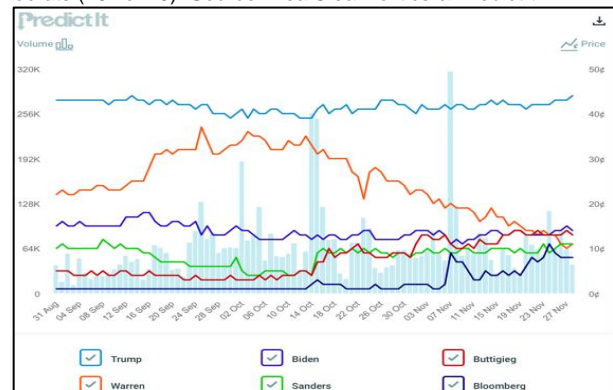
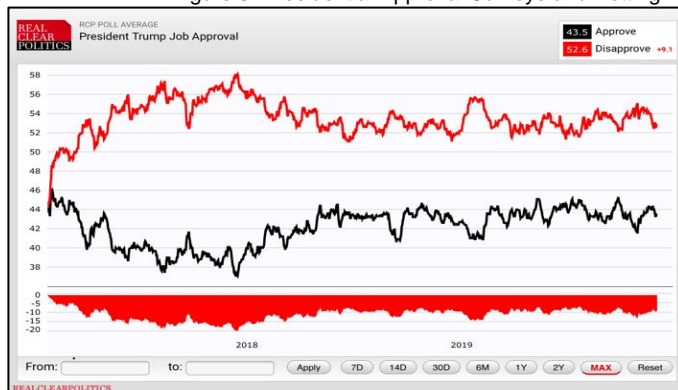
Figure 2. Betting on Trump impeachment (29Nov19). Source: PredictIt



## Trump: presidential approval

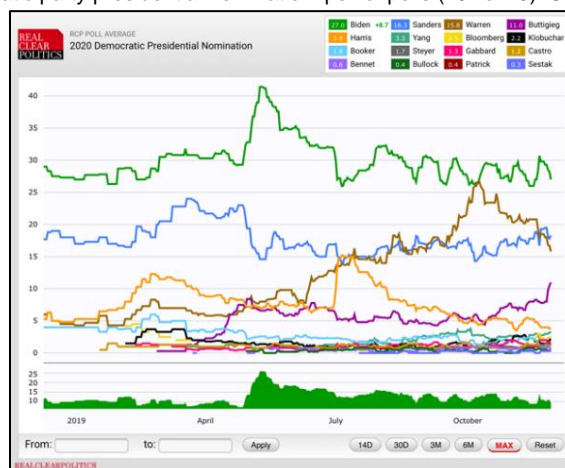
Less than a year before the 2020 election, Trump's level of disapproval remains stable (Figure 3). Election bets continue to favor Trump, unaffected by a possible impeachment.

Figure 3: Presidential Approval Surveys and Betting vs. Democrats (29Nov19). Source: RealClearPolitics &amp; PredictIt



## Democratic party: presidential nomination

Figure 4: Democratic party presidential nomination: poll of polls (29Nov19). Source: RealClearPolitics



Democrat primaries will be held between February 3 and June 16, 2020. So far 3 candidates have taken a clear lead: Biden, Warren, and Sanders. Biden continues in the lead and Warren fell heavily during November. Michael Bloomberg has risen strongly in betting (Figure 3), but not so much in the polls (Figure 4).

## EUROPE

### Brexit and UK elections

In the general election of December 12, the two clear leaders are Boris Johnson with his promises of Brexit at the end of January 2020 and an end to Conservative austerity, and Michael Corbyn (Labour) with his return to 1970s socialism. Johnson is 10% ahead in the polls, but with the breakdown of traditional party lines (right-left) by Brexit, there are still many unknowns. If Johnson wins and Brexit is implemented at end-January 2020 it is still unclear what form it could take (hard or soft Brexit).

## MEXICO

### Increased crime

According to data from the National Public Security System, 177,672 crimes were recorded in October (166,832 in September), just below the 2019 May high with 180,467 crimes. After the massacre of the LeBarón family, Trump expressed his intention to declare drug cartels terrorist organizations. It may facilitate the financial blockade of organized crime and could also be interpreted as a pretext for the US to enter Mexican territory. AMLO rejected this and proposed increased cooperation with the US against drug cartels, which could signal a change of strategy.

### Federal budget

On November 22, the Chamber of Deputies approved the 2020 Budget, one week after the statutory deadline (November 15), and had to be approved at an alternate location, when peasant organizations occupied the Chamber. The main changes were more resources to Ministries and fewer resources (including wages) to independent agencies. Within a week of the approval of the Budget, deputies decided to lower senators' salaries without consulting them as well as increase their taxes, so by 2020, deputies will have a higher salary than senators, if a new correction is not made.

### Infrastructure

Members of the private sector and the government presented the National Infrastructure Plan. The first stage implies investment in 147 projects valued at 859bn. pesos and will be implemented over the next three years. Of the 147 projects, 45 will be constructed in the central area of the country, 49 in the north and 42 in the south, in the logistics, energy, tourism, and manufacturing sectors, *inter alia*. The Plan was a result of the 10.2% decline in construction in 2019, the largest since 2013.

### St Lucia Airport

Studies by NavBlue and Paris Airports said that the proposed runway in St Lucia will have a worse performance than the current Mexico City airport, because it will require lighter aircraft. It will require a significant redesign of airspace to reach an acceptable level of efficiency and runways 1 and 3 will not be able to perform simultaneous operations. The Defense Ministry stated that runways 1 and 2 could operate simultaneously, and that runway 3 will be built in 2052.

### Pemex: cyberattack

On Friday, November 8, Pemex' cybernet was contaminated with a computer virus, affecting at least 5% of the oil company's equipment. The virus locks screens, invades important files, and was accompanied by an attempt at extortion. Rocío Nahle, energy secretary, stated that the virus did not affect either Pemex' operations or the supply of gasoline. The attack, and its financial situation, further calls into question Pemex' credibility.

## ECONOMICS

### US

#### Political/economic disputes between the US and China

Tensions over US-China trade agreements rose, following US support for pro-democracy protesters in Hong Kong, through the suspension of annual navy visits. China has said it will take strong countermeasures.

#### TMEC: pressure for ratification increases

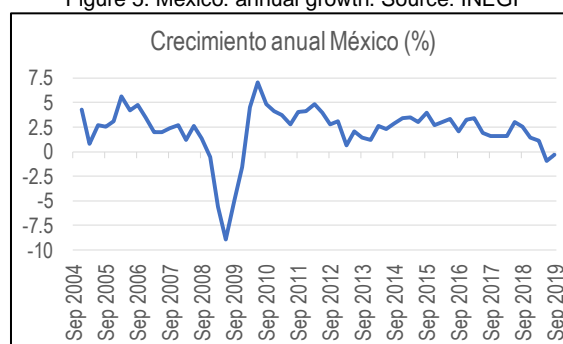
Diplomatic tensions between the US and Mexico over the LeBarón massacre have affected their willingness to ratify the TMEC. Democrats in the US are calling for greater labor guarantees, while in Canada they are waiting for ratification by the US before starting their own ratification process. The due date for congressional approval in 2019 is December 12. If it is not approved in 2019, its approval in 2020 is unlikely owing to complications from a possible Trump impeachment and the electoral process.

### MEXICO

#### Formal recession

On Friday, November 25, with revised figures from INEGI, Mexico's economy was formally declared in a slight recession during the first half of 2019. The economy contracted 0.1% in seasonal terms during the 1st and 2nd quarters of 2019, after a 0.1% decrease in 4Q18. Meanwhile, annual growth has fallen 2Q19 and 3Q19 with a decrease of -0.76% and -0.3% respectively, levels not seen since the great crisis of 2008 (Figure 5).

Figure 5: Mexico: annual growth. Source: INEGI



The 3Q19 figure could also be revised downwards, justifying the lower estimates of growth expected for 2019 in the Bank of Mexico (Banxico) monthly survey, which again lowered its growth expectations from 0.26% to 0.04% for 2019, and 1.21% to 1.08% for 2020 (Figure 6).

Figure 6. Specialists' expectations of the economy. Source: Banxico

	Media		Mediana	
	Encuesta octubre	noviembre	Encuesta octubre	noviembre
<b>Inflación General (dic.-dic.)</b>				
Expectativa para 2019	2.96	2.93	3.00	2.95
Expectativa para 2020	3.43	3.45	3.50	3.50
<b>Inflación Subyacente (dic.-dic.)</b>				
Expectativa para 2019	3.57	3.57	3.60	3.60
Expectativa para 2020	3.35	3.40	3.38	3.40
<b>Crecimiento del PIB (Δ% anual)</b>				
Expectativa para 2019	0.26	0.04	0.20	0.00
Expectativa para 2020	1.21	1.08	1.20	1.07
<b>Tipo de Cambio Pesos/Dólar (cierre del año)</b>				
Expectativa para 2019	19.72	19.59	19.70	19.48
Expectativa para 2020	20.17	20.09	20.10	20.00
<b>Tasa de fondeo interbancario (cierre del IV trimestre)</b>				
Expectativa para 2019	7.33	7.27	7.25	7.25
Expectativa para 2020	6.68	6.57	6.75	6.50

## Inflation

In November, consumer inflation is expected to close 2019 at 3.57%. By 2020, the expectation of annual total and underlying inflation is maintained within Banxico's target range (3.45% and 3.4% respectively). With inflation expectations under control, Banxico has the possibility to continue cutting its interest rate to 7.25% as specialists expect (Figure 7 and 8).

Figure 7. General inflation expectation for 2020 12m. Source: INEGI

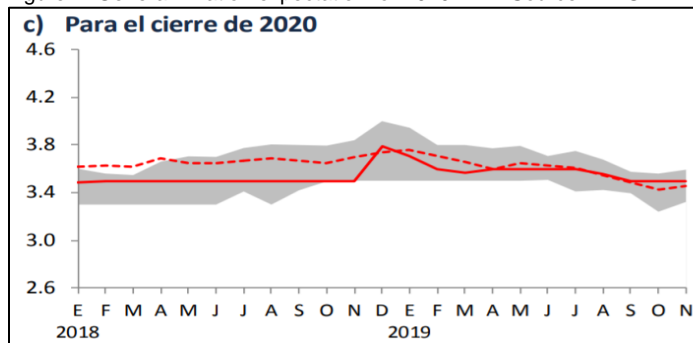
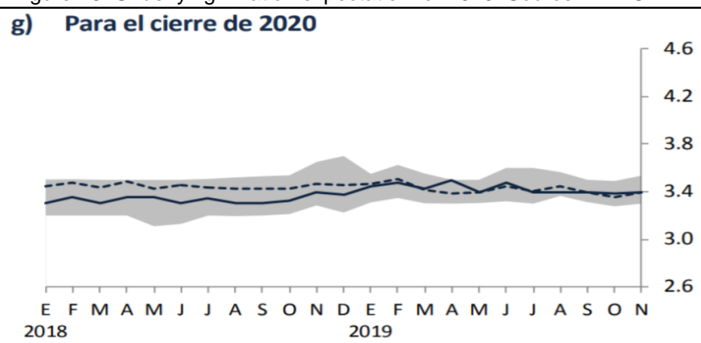


Figure 8. Underlying inflation expectation for 2020. Source: INEGI

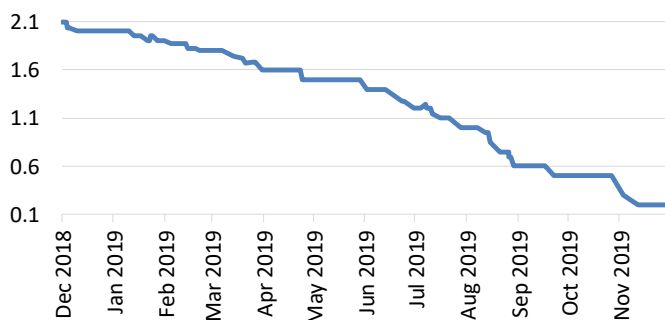


## THE YEAR 2019

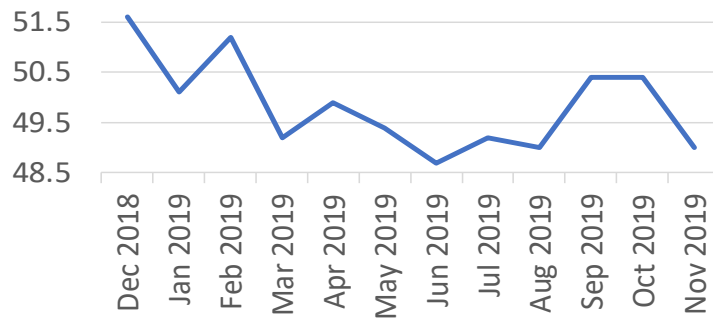
On December 1, exactly one year after AMLO's inauguration, there were two demonstrations. One was held in the main square (Zócalo) of Mexico City where AMLO celebrated his first year with a speech of almost an hour and a half and asked for "one more year." The other was organized in Revolution Square by opponents of his government. Measurable data for 2019 are presented below. The year was not positive in the terms of the economy, security, and the president's popularity. With economic growth, investment, employment and foreign financial turning down, insecurity increased dramatically. This is attributed to the government. In the economy, there were specific actions that reduced investor confidence: the definitive cancellation of the new airport, the renegotiation of contracts for gas pipelines, and changes in property and tax laws. In national security, the inadequate government response to the attacks by cartel gangs in Culiacán and Chihuahua are attributed to the reorganization of the security system focused on the National Guard. For the year 2020 to be better, the government will have to increase the confidence of investors in their attitude towards the rule of law and the private sector, and of citizens in their competence in the organization of the security forces.

## MEXICO 2019: SELECTED INDICATORS

Expected GDP growth 2019 (%)



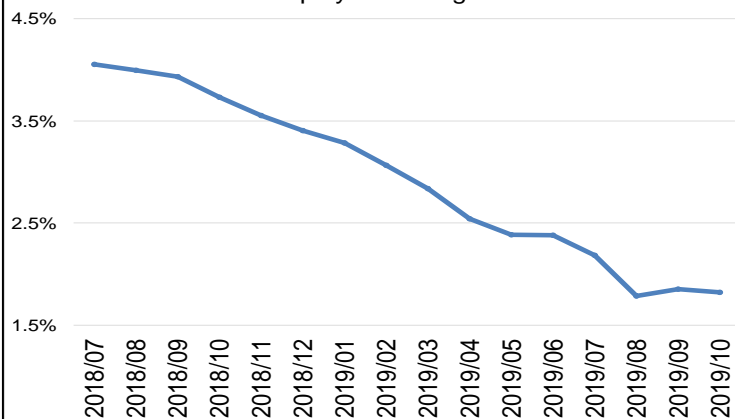
PMI: 2018-19 (index)



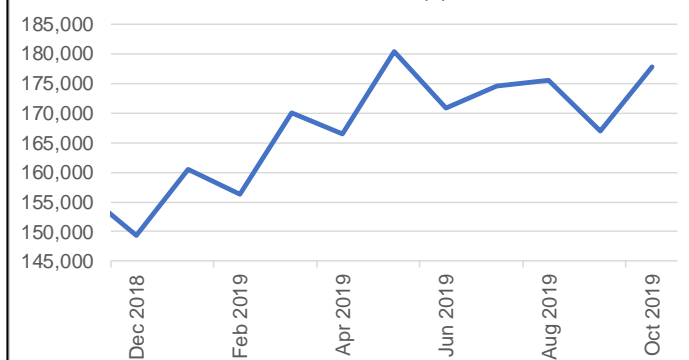
Peso government bonds: % held by foreigners



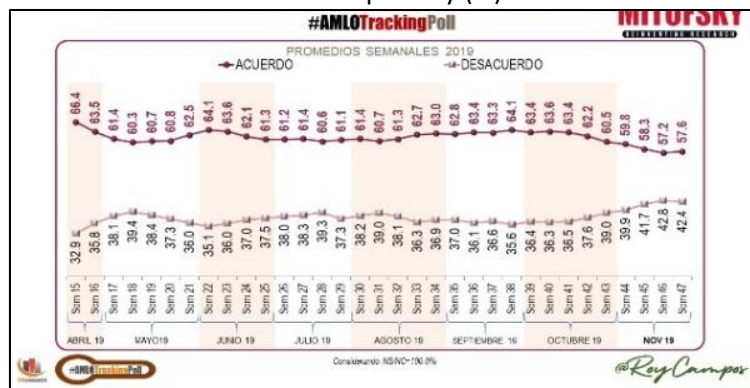
Formal employment: % growth YoY



Total of crimes (#)



AMLO Popularity (%)





## RISKS AND SCENARIOS

The objective is Mexican economic growth. In the positive scenario, all risks turn out favorable for growth, in the negative, unfavorable, and in the middle, mixed. Estimates for each scenario are given in Figure 9.

RISKS	
<i>Global</i>	<ul style="list-style-type: none"> <li>US: monetary policy,, dispute between executive recession and legislative branch</li> <li>Global: trade wars</li> <li>Geopolitics: Europe, Middle East, Russia, China, North Korea, Latin America</li> <li>MS: crisis and contagion</li> </ul>
<i>Mexican</i>	<ul style="list-style-type: none"> <li>Government</li> <li>Security</li> <li>Corruption</li> <li>Oil</li> <li>Debt rating</li> </ul>
SCENARIOS	
<i>Positive (10%)</i>	<ul style="list-style-type: none"> <li>US: expansion continues, trade disputes but no major consequences</li> <li>Monetary policy does not derail cycle.</li> <li>Rapid ratification USMCA.</li> <li>Geopolitical risks do not materialize.</li> <li>Global growth.</li> <li>MS: no crisis or contagion.</li> <li>Mexico: government functions, spending drives infrastructure/consumption, anticorruption and antiviolence work measures, ratings upgrade.</li> </ul>
<i>Negative (50%)</i>	<ul style="list-style-type: none"> <li>US: expansion stops, trade wars affect global commerce.</li> <li>Monetary policy derails cycle.</li> <li>USMCA not ratified, elimination threatened.</li> <li>Geopolitical risks materialize.</li> <li>Global recession.</li> <li>MS: crisis and contagion.</li> <li>Mexico: government dysfunctional, spending out of control, anticorruption and violence measures backfire, ratings downgrade.</li> </ul>
<i>Middle (40%)</i>	<ul style="list-style-type: none"> <li>US: slow expansion continues, rhetorical trade disputes.</li> <li>Adequate monetary policy, but uncertain.</li> <li>USMCA approved late, with changes.</li> <li>Geopolitical: risks materialize partially.</li> <li>Global slowdown, unsynchronized.</li> <li>MS: crisis and some contagion from vulnerable countries.</li> <li>Mexico: government partially functional, continued mixed signals, ratings stable.</li> </ul>

Figure 9. Estimates for scenarios 2020. Source: FT

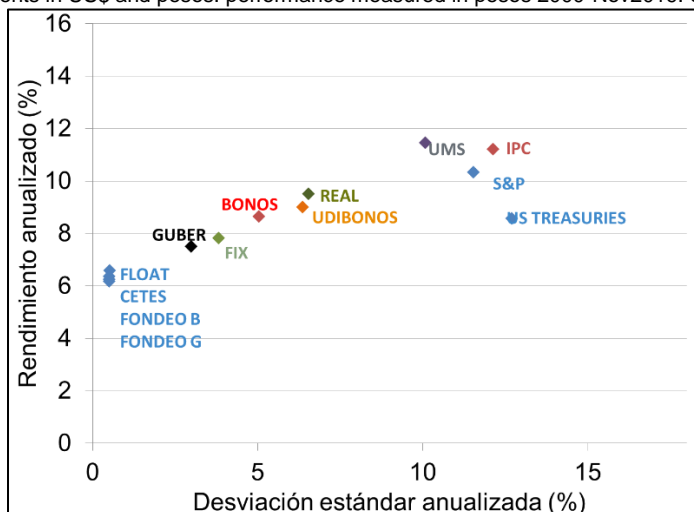
Escenarios para 2020			
	Alto	Bajo	Base
Probabilidad	10%	50%	40%
<u>EU</u>			
Crecimiento PIB	> 1.80%	< 1.80%	1.80%
Inflación	> 2.10%	< 2.10%	2.10%
Déficit fiscal	< 4.80%	> 4.80%	4.80%
Déficit cuenta corriente	< 2.60%	> 2.60%	2.60%
Tasa T-Bills	> 1.77%	< 1.77%	1.77%
TNote 10 US	> 1.93%	< 1.93%	1.93%
Petróleo (WTI)	> \$56.5	< \$56.5	56.50
<u>México</u>			
Crecimiento PIB	> 1.08%	< 1.08%	1.08%
Inflación	> 3.45%	< 3.45%	3.45%
Déficit fiscal	< 2.30%	> 2.30%	2.30%
Déficit cuenta corriente	< 1.40%	> 1.40%	1.40%
Cetes28 (fin de año)	> 6.63%	< 6.63%	6.63%
Peso/US\$ (fin de año)	< \$20.09	> \$20.09	20.09

## MARKETS

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

Following the depreciation of the peso since Trump entered the political stage, in the long run (2000-2019) the gap between peso investment and US\$, both converted to pesos, has narrowed. However, investments in pesos have outperformed US\$ investments (Figure 10).

Figure 10. Investments in US\$ and pesos: performance measured in pesos 2000-Nov2019. Source: FT



### The US\$ and the peso

During November, the peso remained volatile in the face of conflicting announcements of the China-US Trade agreement (Figure 11), and possibly the USMCA. Sentiment measured by Banxico improved: 27% of respondents expect the economy to improve (previous 13%), 49% same (53%) and 24% worse (35%) (Figure 12).

Figure 11. Peso vs. US\$: 1980-Nov2019. Source: FT

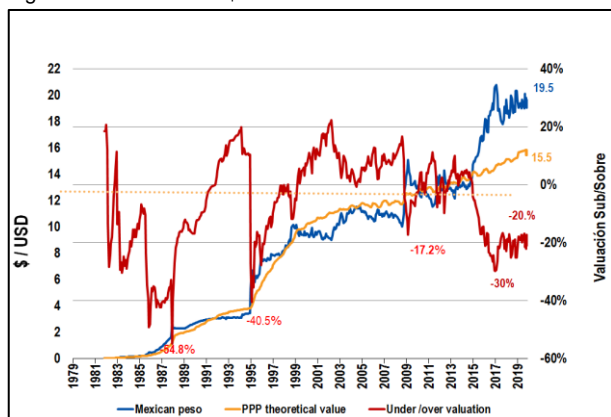
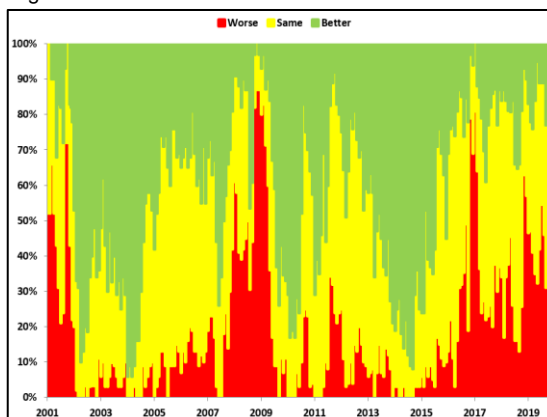


Figure 12. Sentiment Jan2017-Nov2019. Source: Banxico



## Debt

In 2020, rate hikes are expected in most DMs. For EM, hikes are expected in India, Russia and Turkey (Figure 13).

Figure 13. DM and EM: nominal rates 10 years estimated at jun2020 (Nov19). Source: Bloomberg, FT

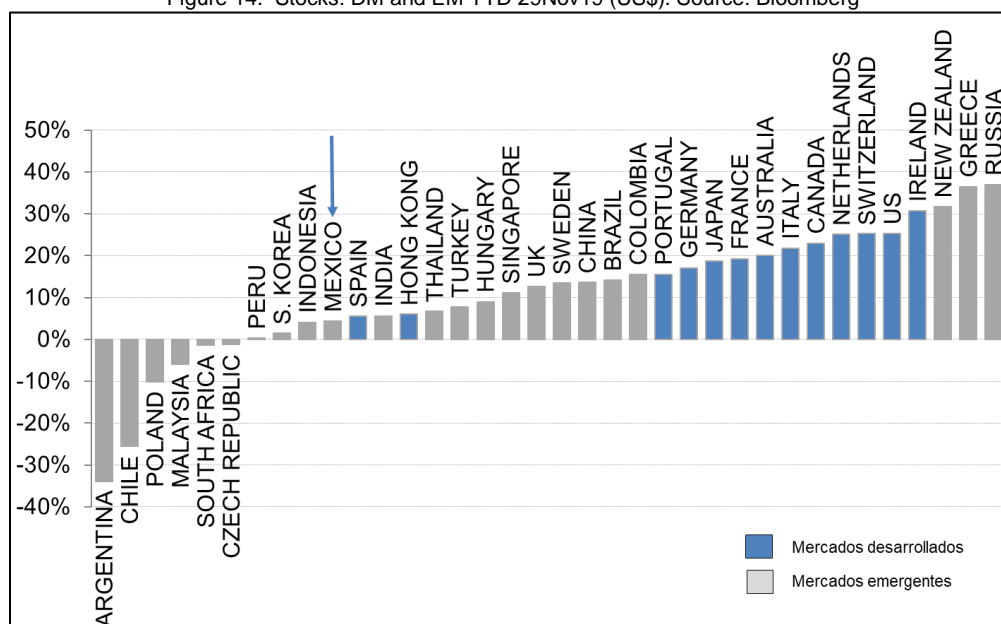
Developed				Emerging			
local 10y yields (%)				local 10y yields (%)			
	4Q20e	Actual	(bps)		4Q20e	Actual	(bps)
US	1.93	1.78	15.42	China	2.90	3.18	-27.5
Euro Area	(0.33)	(0.36)	3	India	6.50	6.47	3.3
Japan	(0.05)	(0.10)	4.5	Rusia	6.56	6.34	21.6
Britain	0.96	0.70	26.3	Brasil	6.63	6.92	-29.4
Australia	0.96	1.03	-7.4	México	6.67	7.10	-42.6
Canada	1.79	1.46	32.7	Corea del sur	1.61	1.64	-2.5
Germany	(0.33)	(0.36)	3	Indonesia	6.89	7.11	-22
France	(0.13)	(0.05)	-8.1	Turquia	12.46	12.44	2



## Stocks

In 2019, most markets have risen with a marked difference between EM and DM (Figure 14).

Figure 14. Stocks: DM and EM YTD 29Nov19 (US\$). Source: Bloomberg



## Fibras (REITs)

Since inception in 2011, Fibras have outperformed stocks (Figure 15). In 2019 they recovered strongly vs. 2018, when they were affected by USMCA. If interest rates stay low, and USMCA is approved, Fibras should benefit more than stocks (Figure 16).

Figure 15. FIBRAS vs. IRT since inception (Mar2011) and Jan18-03Dec19. Source: Bloomberg

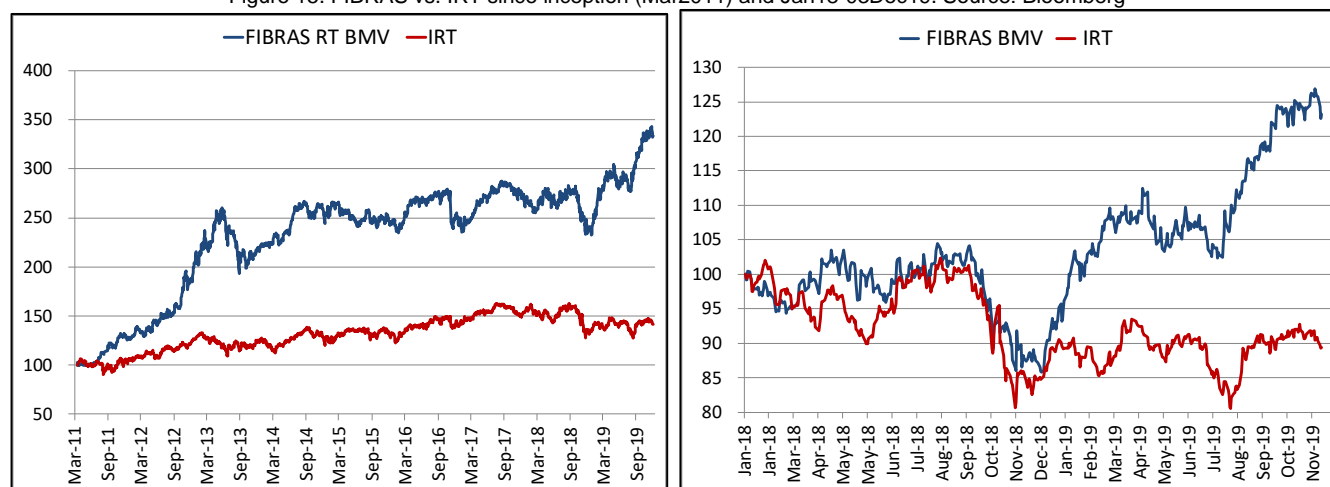


Figure 16. Fibras: valuation and dividends (Dec2019). Source: BTG

Figure 16: Fibras: Valuation and dividends (US\$m FY). Source: BFC								
	Market Cap (US\$m)	Dividend Yield %				Price / NAV		
		Current	2018	2019E	2020E	2018	2019E	2020E
Mexican FIBRAS								
Fibra Uno	6,003	7.8%	7.2%	7.8%	8.2%	0.74	0.81	0.82
Fibra MQ	1,081	6.7%	5.8%	6.2%	6.5%	0.79	0.76	0.74
Fibra Shop	240	9.7%	11.7%	9.2%	7.3%	0.44	0.44	0.44
Fibra Terrafina	1,291	8.7%	8.3%	8.0%	8.3%	0.88	0.92	0.89
Fibra Danhos	2,036	8.6%	8.1%	8.6%	8.4%	0.72	0.72	0.74
Fibra Prologis	1,357	5.8%	5.4%	5.9%	6.8%	0.87	0.89	0.90
Fibra Hotelera	379	7.4%	11.2%	10.3%	10.5%	0.55	0.55	0.55
Fibra Inn	192	7.0%	14.0%	14.7%	15.1%	0.36	0.36	0.35
Fibra Monterrey	394	9.7%	8.8%	9.2%	9.1%	0.87	0.87	0.86

**Conclusion**

Globally, 2019 was a good year for risk assets, despite political and economic uncertainty that could affect not only the economy, but also the markets in 2020. In Mexico, no improvement in the outlook is expected unless there is an increase in private sector confidence and the competence of the security forces. We advise caution for portfolios denominated in pesos, overweight liquidity and ILS debt of 1 to 3 years, underweight shares and benchmark weight REITs (Fibras).

**Ramsé Gutierrez**  
**Nadia Montes de Oca**  
**Jorge Marmolejo**  
**Luis Gonzalí**  
**Publisher: Timothy Heyman**  
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**Key financial variables: performance as of November 29, 2019**

During November, in the US: DJ, S&P500 and Nasdaq rose. Nominal and actual rates rose, except for 30 years. WTI price rose 1.83%. The US\$ strengthened 1.77% against the peso. In Mexico, IRT fell 0.62% and FIBRAS RT rose 2.42%. Nominal and actual rates rose, except for 28 days. Regarding the business climate according to Banxico, optimism rose to 27% (previous 13%), no change fell to 49% (53%), and pessimism fell to 24% (35%).

Mexico					
Stock market and oil					
	29-Nov-19	31-Oct-19	Month	YTD	2018
IRT	60,181.60	60,554.71	-0.62%	6.01%	-13.62%
BIVA RT	932.76	936.09	-0.36%	7.43%	-13.18%
FIBRAS BMV RT	340.41	332.38	2.42%	46.07%	-12.67%
Local currency (USD/MXN)	19.54	19.19	1.77%	-0.59%	-0.06%
Mexican oil mix (USD/bbl)	50.98	48.08	6.03%	14.07%	-20.47%
Nominal rates					
	29-Nov-19	31-Oct-19	Month	YTD	2018
CETES 28	7.52%	7.61%	-9 bps	-90 bps	110 bps
CETES 360	6.71%	6.52%	19 bps	-178 bps	103 bps
M5	6.95%	6.57%	37 bps	-157 bps	93 bps
M10	7.09%	6.76%	32 bps	-157 bps	101 bps
M30	7.34%	7.15%	19 bps	-155 bps	111 bps
Real rates					
	29-Nov-19	31-Oct-19	Month	YTD	2018
UDIBONO 10	3.32%	3.20%	13 bps	-79 bps	61 bps
UDIBONO 30	3.40%	3.28%	12 bps	-72 bps	42 bps
Commodities					
	29-Nov-19	31-Oct-19	Month	YTD	2018
Gold	1,464.30	1,511.63	-3.13%	14.34%	-1.70%
WTI (USD/bbl)	55.17	54.18	1.83%	23.45%	-20.47%
UMS					
	29-Nov-19	31-Oct-19	Month	YTD	2018
UMS 10 years	3.23%	3.35%	-12 bps	-169 bps	129 bps
UMS 20 years	4.24%	4.37%	-13 bps	-154 bps	125 bps
UMS 30 years	4.63%	4.51%	12 bps	-121 bps	120 bps
Stock markets (US\$)					
	29-Nov-19	31-Oct-19	Month	YTD	2018
MSCI Developed	9,685.18	9,418.38	2.83%	24.62%	-8.20%
MSCI Emerging	2,391.17	2,394.31	-0.13%	10.57%	-14.25%
MSCI Mexico	8,494.54	8,668.00	-2.00%	6.68%	-15.29%
MSCI Brazil	7,124.12	7,450.85	-4.39%	12.62%	-0.15%

US					
Stock market					
	29-Nov-19	31-Oct-19	Month	YTD	2018
DJ	28,051.41	27,046.23	3.72%	20.25%	18.04%
S&P	3,140.98	3,037.56	3.40%	25.30%	11.97%
Nasdaq	8,665.47	8,292.36	4.50%	30.60%	23.26%
Nominal rates					
	29-Nov-19	31-Oct-19	Month	YTD	2018
Tbill 90	1.59%	1.54%	5 bps	-86 bps	194 bps
Tnote 5	1.62%	1.51%	11 bps	-89 bps	58 bps
Tnote 10	1.78%	1.69%	9 bps	-91 bps	24 bps
Tbond 30	2.21%	2.17%	4 bps	-77 bps	-8 bps
Real rates					
	29-Nov-19	31-Oct-19	Month	YTD	2018
Tip 5	0.12%	0.07%	5 bps	-88 bps	91 bps
Tip 10	0.17%	0.15%	2 bps	-81 bps	48 bps
Tip 30	0.50%	0.55%	-5 bps	-71 bps	22 bps

Bank of Mexico survey		
Indicator	2019	2019 anterior
PIB	0.04%	0.26%
Inflation	2.93%	2.96%
Cetes 28	7.27%	7.32%
Local currency	19.59	19.72
Business conditions		
	29-Nov-19	31-Oct-19
Optimism	27%	13%
No change	49%	53%
Pessimism	24%	35%

Source: Bloomberg, Bank of Mexico

**IMPORTANT LEGAL INFORMATION**

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\*Timothy Heyman, President of FTSAM, founded Heyman and Associates in 1985. In 2013, Franklin Templeton established FTSAM and merged it with Heyman and Associates.

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