

Contagion

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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

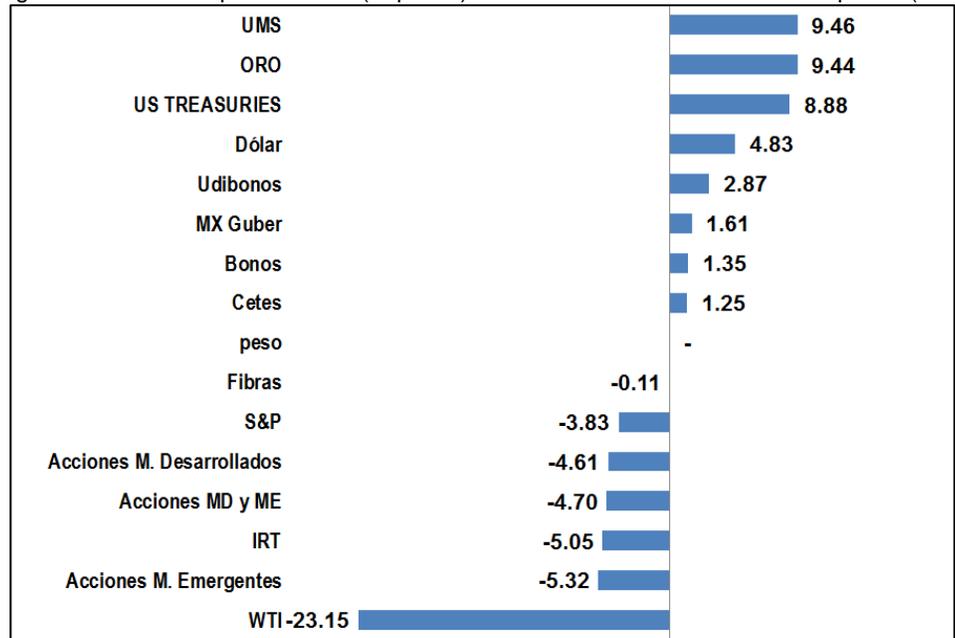
- Global. Markets volatile due to coronavirus. Lower rates by central banks do not alleviate fears of slowdown, due to global demand and supply shocks.
- Mexico. Markets and economy aggravated by global contagion. Approval of AMLO declines due to feminicides, insecurity and healthcare system crisis.
- Global risks: coronavirus, overindebtedness, trade wars, geopolitics, Brexit/Europe, US elections.
- Local risks: private sector confidence, governance, country credit rating.
- Investment scenarios with probabilities: positive (10%), negative (50%), middle (40%).
- Overweight ILS, take profits on REITs, underweight stocks.

"If there is any form of contagion that is adaptive, it is the immediate response to the fear of others."- Frans de Waal

Market volatility, growth estimates lowered

In February, volatility was high and risk assets fell, especially stocks and oil, due to the new coronavirus. With its unpredictable spread from China to the rest of the world, there is an effect on supply (supply chains) and demand (reduction in activity), with worse prospects for businesses (shares and bonds), all exaggerated by uncertainty about its duration and virulence. Assets perceived as safe such as government bonds, have benefited (Figure 1). Lower rates by central banks have not alleviated fears of a negative spiral generated by the interaction between the real economy and financial markets. Until it is understood, the virus poses the greatest foreseeable risk to the economy and investments. In Mexico, it increases the probability of stagnation, which could only be curbed by improved governance and private sector confidence.

Figure 1. Investment performance (% pesos) at 28Feb20. Source: Franklin Templeton ("FT")



INTERNATIONAL

Coronavirus: history and description

On 31 December 2019 in Wuhan, China, a person infected with a new coronavirus (COVID-19) was reported for the first time. Since then, +97,000 infections, +53,000 recoveries and +3,000 deaths have been recorded. Cases have been reported in 90 countries (Figures 2 and 3).

Figure 2. Cases registered by country as of March 4. Source: Johns Hopkins CSSE

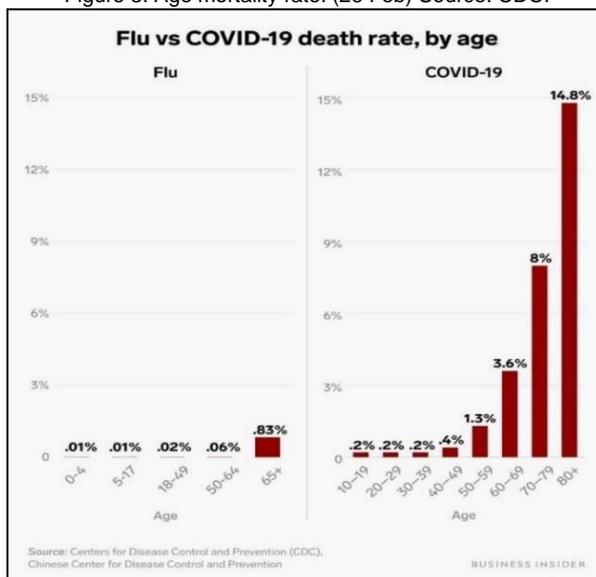
80,422 Mainland China	87 Norway	28 United Arab Emirates	6 Azerbaijan	3 Philippines	1 Dominican Republic
6,088 South Korea	82 Netherlands	21 San Marino	6 Romania	3 Estonia	1 Ukraine
3,858 Italy	58 Kuwait	16 Oman	6 Ireland	3 Egypt	1 South Africa
3,513 Iran	55 Bahrain	16 Vietnam	6 Belarus	2 Slovenia	1 Liechtenstein
706 Others	55 Australia	16 Lebanon	5 Saudi Arabia	2 Bosnia and Herzegovina	1 Faroe Islands
482 Germany	50 Malaysia	16 Israel	5 Pakistan	2 Indonesia	1 Luxembourg
377 France	50 Belgium	13 Ecuador	5 Mexico	2 Hungary	1 Andorra
360 Japan	47 Thailand	12 Czech Republic	4 Palestine	2 Morocco	1 Gibraltar
259 Spain	44 Taiwan	12 Finland	4 Russia	1 Lithuania	1 Nigeria
177 US	41 Austria	12 Algeria	4 Senegal	1 Cambodia	1 Nepal
117 Singapore	37 Canada	10 Macau	4 Brazil	1 Argentina	1 Jordan
115 UK	35 Iraq	10 Denmark	4 Chile	1 North Macedonia	1 Poland
114 Switzerland	34 Iceland	10 Croatia	4 Georgia	1 Monaco	1 Latvia
105 Hong Kong	31 Greece	8 Portugal	3 Saint Barthelemy	1 Afghanistan	1 Tunisia
94 Sweden	30 India	8 Qatar	3 New Zealand	1 Armenia	1 Sri Lanka

Figure 3. Deaths recorded by country as of March 4. Source: Johns Hopkins CSSE

2,912 Mainland China	8 US
92 Irán	1 Spain
80 Italy	1 Australia
28 South Korea	1 Philippines
6 Japan	1 Taiwan
6 Diamond Princess	1 Thailand
4 France	1 Iraq
2 Hong Kong	

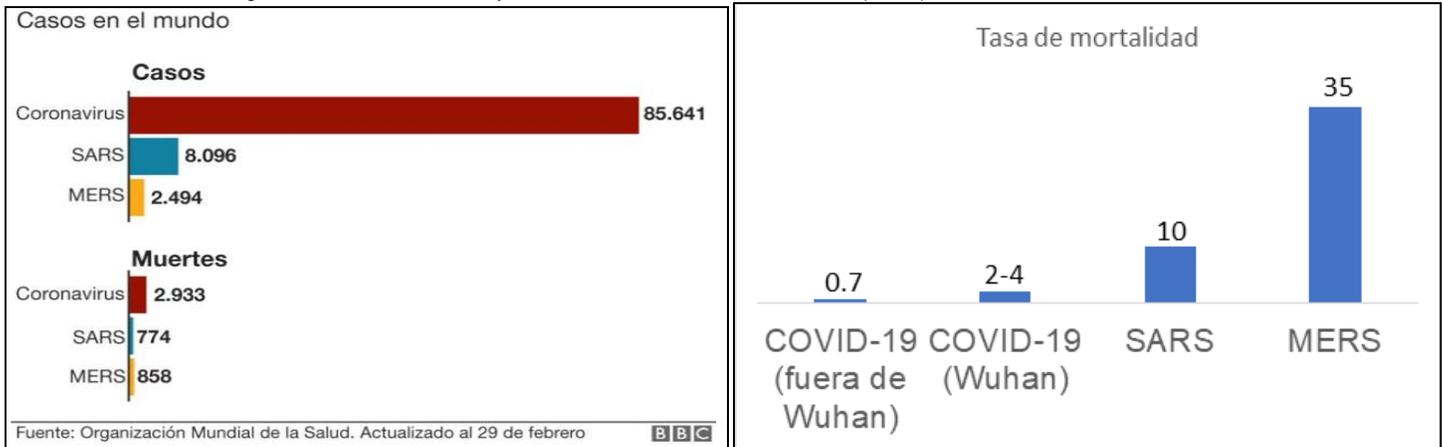
Coronaviruses are an extensive family of viruses that cause respiratory infections in both humans and animals. Symptoms include fever, tiredness and a dry cough. In some cases, pain, nasal congestion, sore throat or diarrhea may occur. Symptoms are usually mild and appear gradually. The incubation period ranges from 1 to 14 days (5 average), according to the World Health Organization (WHO). WHO states that it is too soon to understand COVID-19 mortality rates. Of known infection cases, the highest mortality rate is 14.8% for the >80 year group. (Figure 3)

Figure 3. Age mortality rate. (26 Feb) Source: CDC.



Of confirmed cases, 51.4% are men and 48.6% are female. Of recorded deaths, 63.8% are men and 36.2% are women. Of the deaths, some patients had reported previous ailments: 10.5% cardiovascular, 7.3% diabetes, 6.3% chronic respiratory disease, 6% hypertension and 5.6% cancer. Compared to similar outbreaks, more cases of COVID-19 have been reported. However, the mortality rate is lower than in the case of MERS or SARS. (Figure 4)

Figure 4. Cases and mortality rates: COVID-19, MERS and SARS. (29feb) Source: WHO, CSIC and BBC



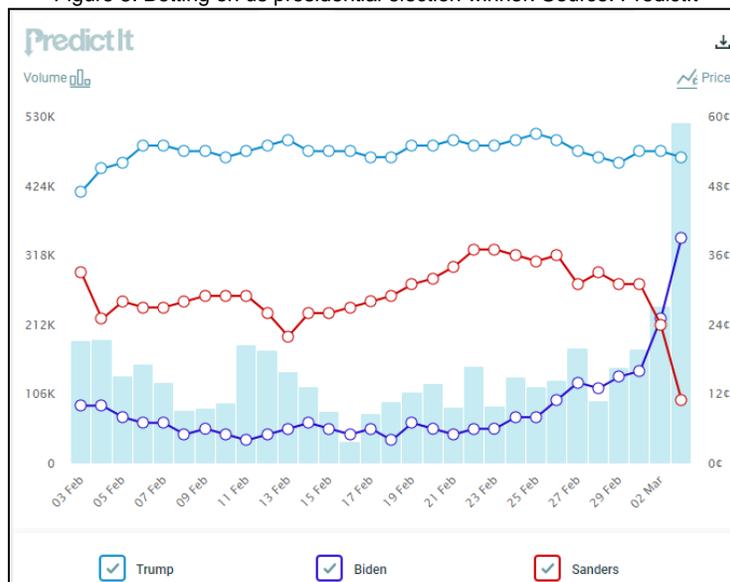
On 24 February, WHO issued an international alert to prepare for a possible pandemic. The last reported pandemic in the world was the H1N1 influenza in 2009, which lasted 14 months with a mortality rate of 0.02%. Since the issuance of the alert several countries have implemented security measures such as: quarantines, cancellation of mass events, and avoidance of concentrations of more than 1,000 people, among others.

POLITICS
US

Democratic party: primaries

On March 3, Democratic primaries were held in 14 states, with 1,357 delegates. Biden won in 9 of them (Alabama, Arkansas, North Carolina, Massachusetts, Minnesota, Oklahoma, Tennessee, Virginia and Texas) and Sanders won only 3 (Vermont, Colorado and Utah). Bloomberg won 1 and Warren 0. Bloomberg retired from the contest and endorsed Biden. To win the nomination, 1,991 delegates are needed. Including previous primaries, Biden has 492, Sanders 423, Warren 53, Bloomberg 46, Buttigieg 26, Klobuchar 7 and Gabbard 1. Only Biden and Sanders are now left in the contest.

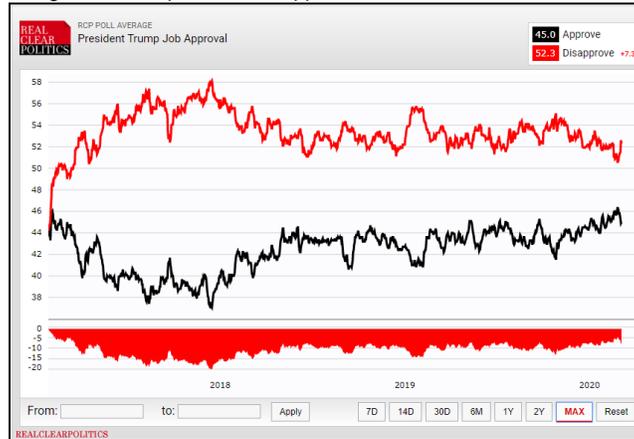
Figure 5. Betting on us presidential election winner. Source: PredictIt



Trump popularity

In late February, Trump's popularity reached a record high since his election. Following his statements about the management of the coronavirus, it fell. However, the positive trend began last October (Figure 6).

Figure 6. U.S. presidential approval. Source: Real Clear Politics



MEXICO

Coronavirus

On 28 February, 3 cases of coronavirus were confirmed in Mexico, 2 in Mexico City and 1 in Sinaloa. They are 3 men who for work reasons traveled to Italy on different dates, where they had contact with an infected Italian citizen. There is a Mexican who also had contact, but his whereabouts are unknown. As of March 4, there are 5 confirmed cases in Coahuila, Sinaloa, Chiapas, Mexico City and the State of Mexico, with mild symptoms and a carrier without symptoms. There are also 39 suspected cases. Despite the geographical dispersion of cases, the government has insisted that coronavirus does not yet pose a threat to the population as all detected cases are "imported". It does not consider that the economy will be affected. There are no controls at major airports, and they have merely issued health recommendations. The Undersecretary of Prevention and Health Promotion, Hugo López-Gatell, estimates that up to 70% of the population could be infected, of which 10-12% could have symptoms and only 2-5% could have serious illness. The coronavirus arrives in Mexico at a time when problems have been encountered in the operation of the Institute of Health for Welfare (INSABI). In addition, there have been widespread medicine shortages. Currently screening tests can only be applied if two requirements are met: 1) that the patient has symptoms and 2) has recently traveled to one of the countries with reported cases and/or has been in direct contact with an already diagnosed patient. This protocol does not detect patients without symptoms.

AMLO popularity

AMLO's approval ratings have deteriorated to a low of 54.1%. This is attributed to the rise of insecurity, feminicides and his contempt for the women's demonstration scheduled for March 9, the shortage of medicines, the distraction of the "raffle" of the presidential plane, the threat of judicial changes that seem authoritarian and the divisions in Morena.

Figure 7. Presidential approval as of March 2. Source: The Economist

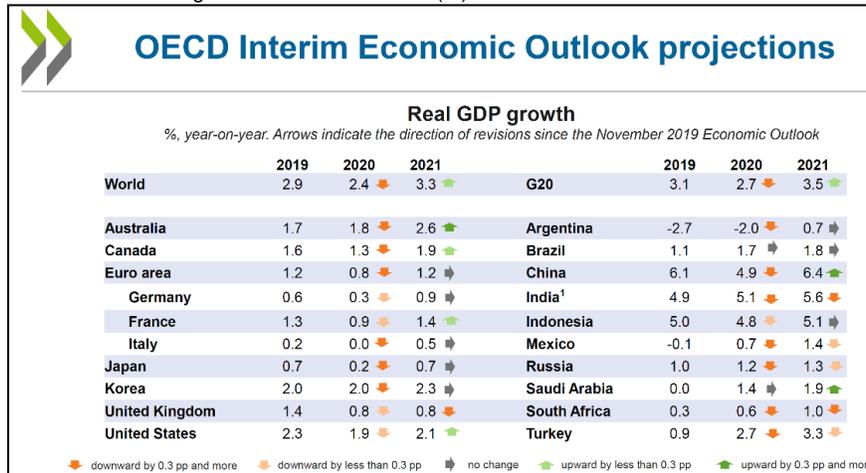


ECONOMY

Global growth

Due to coronavirus, the OECD reduced estimated global growth to 2.4%, and for Mexico to 0.7%. It seems that the longest recovery since World War II is nearing completion and that the liquidity bubble caused by the record level of global debt (see February Monthly Perspective) could, for an unexpected cause (“black swan”) be burst, as in the case of many bubbles.

Figure 8. Growth estimates (%) 2019-2021. Source: IMF



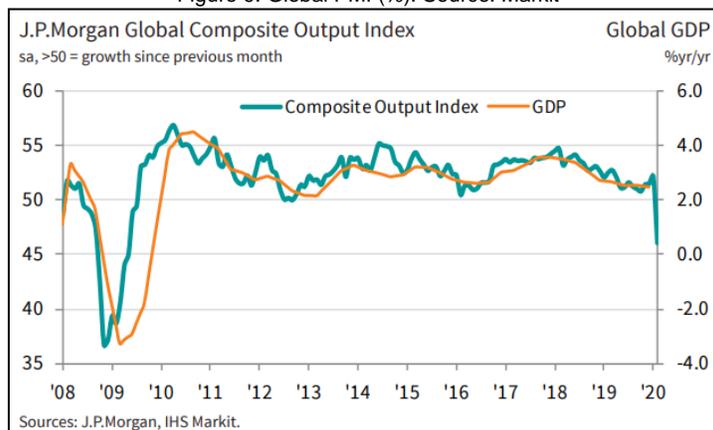
Central banks: monetary stimulus

Globally, central banks, including China, have cut benchmark rates to stimulate the economy. In the Eurozone governments have reiterated support for the most affected sectors such as tourism. In the US, Congress was asked to approve US\$ 2.5bn. to combat the virus and on March 3 the Fed surprisedly reduced its benchmark rate by 0.5%. There had been no decision outside of a scheduled meeting date since the 2008 financial crisis.

PMI coming down

According to data published by Markit, global PMI stood at 46.1 in February (January: 52.2), a sharp fall that had not been seen since 2009 (Figure 9). It is the second-highest fall in history, after October 2001. The biggest fall was recorded in China, followed by the US, Japan and Australia.

Figure 9. Global PMI (%). Source: Markit



Short and long term repercussions

In the short term, the possibility of a financial crisis is being aired where low economic activity causes financial stress in companies, with the consequence negative spirals in markets, as happened in the subprime crisis of 2008-9. In the long run, the effect on China as a leading supplier of cheap inputs may be lasting. Diversification of supplies had already begun with the trade war started by Trump, and could be accentuated by the coronavirus crisis. One of the beneficiaries could be Mexico.

MEXICO

Economic growth

For 2019, GDP was officially announced at -0.1%. According to an analyst, growth scenarios for 2020 depend on the duration of the virus, ranging from 0.6% to -1.1% (Figure 10). The Treasury (SHCP) announced attempts to increase growth by accelerating 1) tenders and acquisitions, 2) projects with states, and 3) private investment.

Figure 10. Mexico growth estimates by virus duration date (%) 2019-2021. Source: Morgan Stanley

Real GDP%	March	2Q20	3Q20
2020e	0.6	-0.2	-1.1
2021e	1.5	1.8	2.1

Foreign direct investment (FDI)

During 2019, FDI increased to US\$32,921mn. from US\$31,604mn (2018). Main investors are: USA 37%, Spain 12.1%, Canada 9.7%, Germany 9.2%: 47.2% manufacturing, 15.3% financial services, 9.7% trade, 5.5% mass media; 53.1% profit reinvestment, 39% new investments, 7.9% intercompany accounts.

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 14.

	RISKS
<p><i>Global</i></p> <ul style="list-style-type: none"> • Biological (e.g. coronavirus) or climate (e.g. Australia) emergency • Global: excess liquidity destabilizes cycle and markets • US: recession after record expansion • Global: trade wars • Geopolitics: Europe, Middle East, Russia, China, North Korea, Latin America • EM: crisis and contagion <p><i>Mexican</i></p> <ul style="list-style-type: none"> • Government • Security • Corruption • Governance • Oil • Debt rating 	
<p><i>Positive (10%)</i></p> <ul style="list-style-type: none"> • Coronavirus resolved quickly • Global. Monetary policy does not derail cycle or markets • US: expansion continues, trade disputes but no major consequences. • Geopolitical risks do not materialize. • Global growth. • EM: no crisis or contagion. • Mexico: government functions, spending drives infrastructure/consumption, anticorruption and antiviolence measures work, ratings upgrade. <p><i>Negative (50%)</i></p> <ul style="list-style-type: none"> • Coronavirus goes global • Monetary policy derails cycle • US: expansion stops, trade wars affect global commerce. • Geopolitical risks materialize. • Global recession. • EM: crisis and contagion. • Mexico: government dysfunctional, spending out of control, anticorruption and violence measures backfire, ratings downgrade. <p><i>Middle (40%)</i></p> <ul style="list-style-type: none"> • Coronavirus similar to SARS • Adequate monetary policy, but uncertain. • US: slow expansion continues, rhetorical trade disputes. • Geopolitical: materialize partially. • Global slowdown, unsynchronized. • EM: crisis and some contagion from vulnerable countries. • Mexico: government partially functional, continued mixed signals, ratings stable. 	<p>SCENARIOS</p>

Figure 11. Estimates for 2020 scenarios (*observed 2019) Source: FT

	Escenarios para 2020			2019
	Alto	Bajo	Base	Observados
Probabilidad	10%	50%	40%	
EU				
Crecimiento PIB	> 1.80%	< 1.80%	1.80%	2.30%
Inflación	> 2.00%	< 2.00%	2.00%	1.80%
Déficit fiscal	< 4.80%	> 4.80%	4.80%	4.70%
Déficit cuenta corriente	< 2.40%	> 2.40%	2.40%	2.5%*
Tasa T-Bills	> 1.65%	< 1.65%	1.65%	1.75%
TNote 10 US	> 1.92%	< 1.92%	1.92%	1.92%
Petróleo (WTI)	> \$47.77	< \$47.77	47.77	61.06
México				
Crecimiento PIB	> 0.91%	< 0.91%	0.91%	-0.10%
Inflación	> 3.52%	< 3.52%	3.52%	2.83%
Déficit fiscal	< 2.50%	> 2.50%	2.50%	1.60%
Déficit cuenta corriente	< 1.10%	> 1.10%	1.10%	0.5%*
Cetes28 (fin de año)	> 6.45%	< 6.45%	6.45%	7.30%
Peso/US\$ (fin de año)	< \$19.57	> \$19.57	19.57	18.86

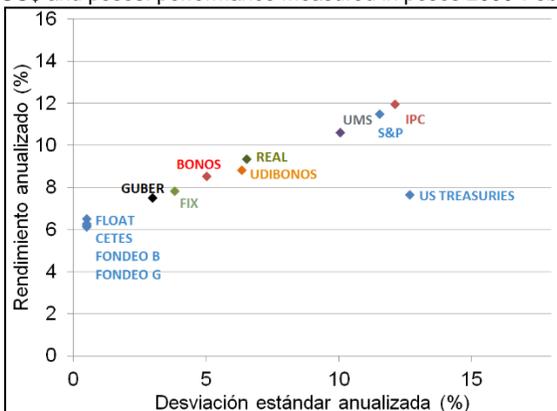
Fuentes Franklin Templeton, Bloomberg y Encuesta Banxico (publicada el 2 de marzo de 2020). * Pronósticos

MARKETS

Investments in US\$ and pesos: comparative performance

After the depreciation of the peso, in the long term (2000-2020) the gap between investments denominated in pesos and US\$, both converted to pesos, has widened. However, investments in pesos have outperformed US\$ investments (Figure 12).

Figure 12. Investments in US\$ and pesos: performance measured in pesos 2000-Feb2020. Source: FT



The US\$ and the peso

The panic generated by the coronavirus has led to a widespread fall in currencies against the dollar, including the peso (Figures 13 and 14). Sentiment measured by Banxico (in mid-February): 21% better (previous 25%), 62% no change (56%), 18% worse (19%) (Figure 15).

Figure 13. Peso vs. US\$: 1980-3Mar2020. Source: FT

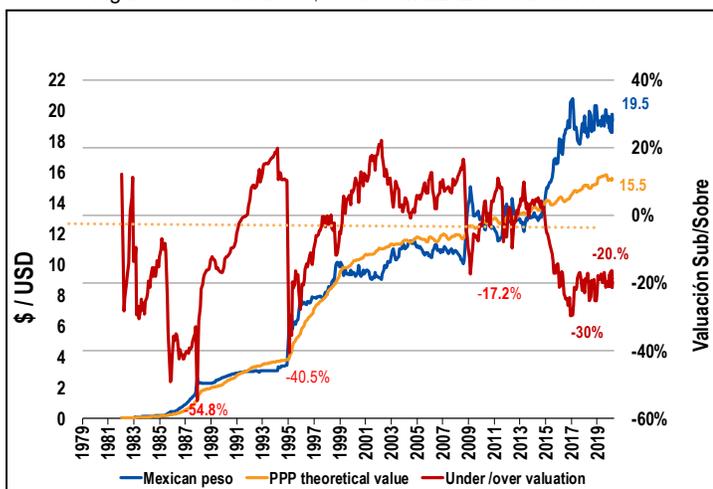


Figure 14. Emerging currencies vs. US\$ 3Mar20 Source: FT

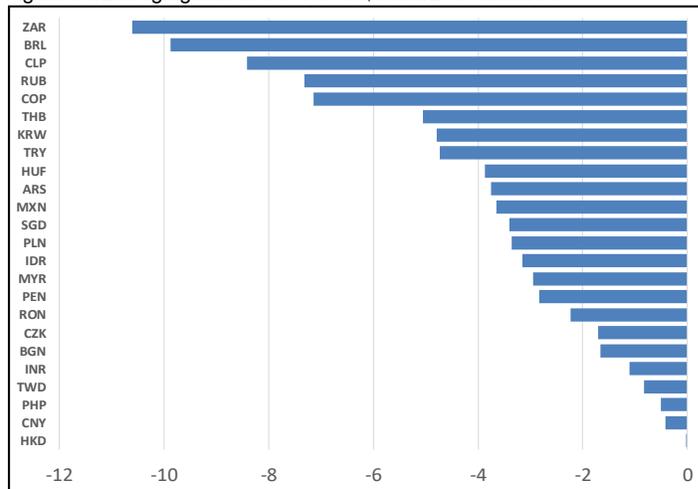
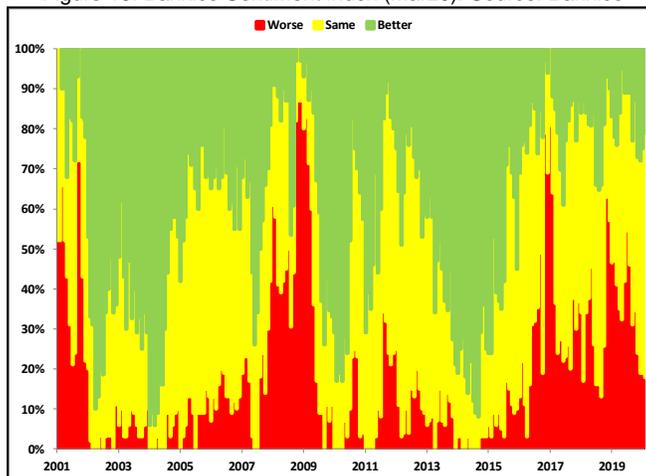


Figure 15. Banxico Sentiment index (Mar20). Source: Banxico



Debt

After recent rate falls, analysts expect mixed rate movements in EM and DM by end-2020, with the majority rising (Figure 16).

Figure 16. DM and EM: nominal 10 year rates estimated at Dec2020 (mar20). Source: Bloomberg, FT

Developed local 10y yields (%)				Emerging local 10y yields (%)			
	4Q20e	Actual	(bps)		4Q20e	Actual	(bps)
US	1.92	0.98	93.55	China	2.84	2.76	7.7
Euro Area	(0.28)	(0.63)	34.5	India	6.50	6.34	15.7
Japan	(0.05)	(0.12)	6.5	Rusia	6.24	6.14	10.1
Britain	0.82	0.39	43	Brasil	6.58	6.63	-4.7
Australia	1.00	0.75	25	México	7.05	6.45	60
Canada	1.69	0.96	72.9	Corea del sur	1.75	1.38	37
Germany	(0.28)	(0.63)	34.5	Indonesia	6.70	6.80	-9.6
France	(0.05)	(0.32)	27.4	Turquia	10.82	12.18	-136

Stocks

Uncertainty about coronavirus has affected all markets (Figures 17, 18 and 19).

Figure 17. Shares DM and EM YTD 4Mar2020 (US\$). Source: Bloomberg

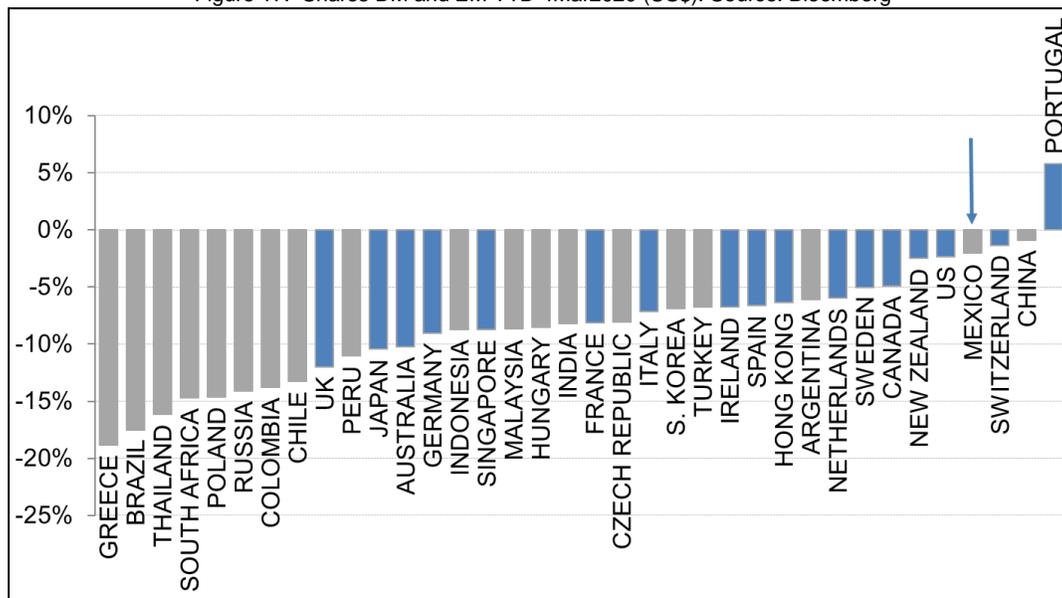


Figure 18. S&P500 03Mar20 (US\$). Source: FT

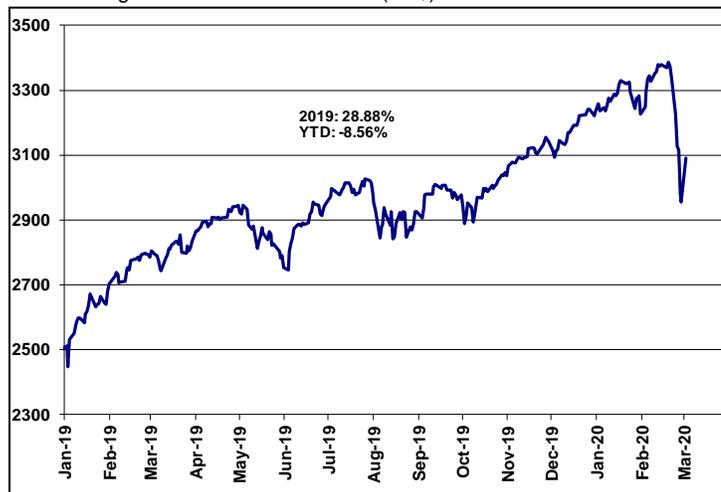
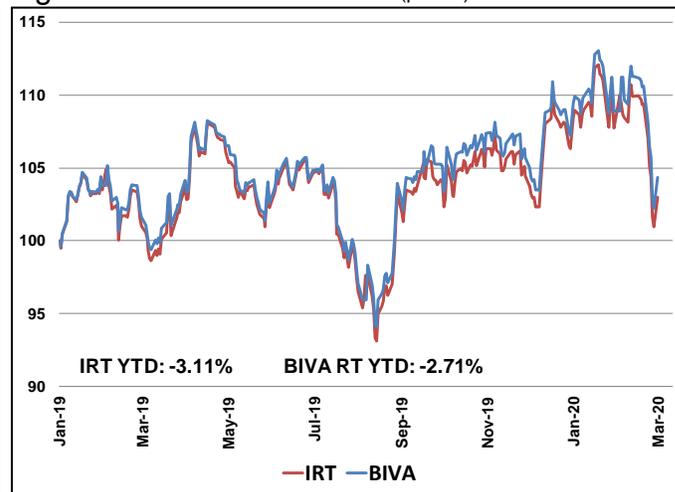


Figure 19. IRT and BIVART 03Mar20 (pesos). Source: FT



REITs (Fibras)

Despite the fall in the last days of February, REITs continue to outperform (Figures 20 and 21).

Figure 20. REITs vs.Stocks IRT since inception (Mar2011) and Jan19-03Mar20. Source: Bloomberg

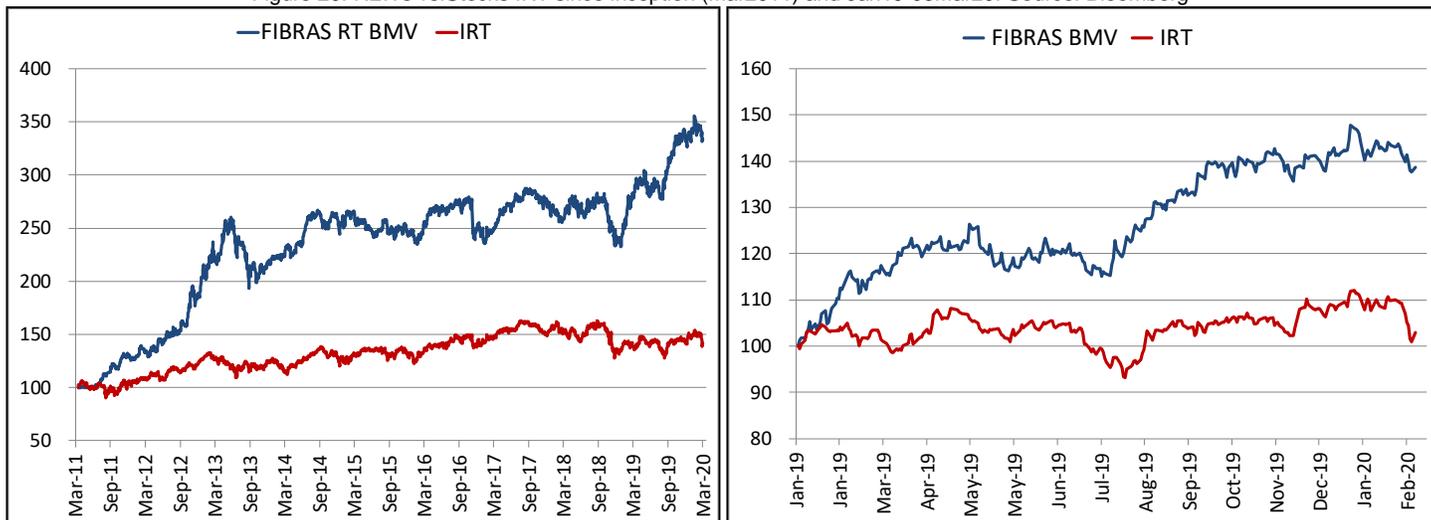


Figure 21. REITs: valuation and dividends (mar2020). Source: BTG

	Market Cap	Dividend Yield %			Price / NAV	
	(US\$m)	Current	2019E	2020E	2019E	2020E
Mexican FIBRAS						
Fibra Uno	6,459	7.5%	7.5%	7.6%	0.74	0.75
Fibra MQ	1,055	7.1%	6.8%	7.6%	0.72	0.68
Fibra Shop	272	8.8%	8.8%	8.6%	0.45	0.42
Fibra Terrafina	1,288	9.1%	8.3%	8.8%	0.83	0.81
Fibra Danhos	2,130	8.5%	8.4%	8.5%	0.72	0.74
Fibra Prologis	1,417	5.7%	5.7%	6.5%	0.87	0.88
Fibra Hotelera	357	8.2%	11.3%	11.6%	0.50	0.50
Fibra Inn	221	6.3%	13.3%	13.7%	0.39	0.38
Fibra Monterrey	613	9.8%	6.1%	6.9%	0.95	0.94

Conclusion

Globally, until it is understood, the coronavirus poses the greatest risk to the economy and investments. In Mexico, this new risk increases the probability of stagnation, which would only be curbed by an improvement in governance and private sector confidence. We continue to assign similar probabilities to each scenario: positive 10%, negative 50% and middle 40%, and recommend caution for portfolios denominated in pesos, with an overweight in inflation linked instruments, profit taking in REITs and underweight in stocks.

Nadia Montes de Oca
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Editor: Timothy Heyman
March 6, 2020

Key financial variables: performance as of February 28, 2020

During February, in Mexico, the IRT was down 6.30% and FIBRAS RT 2.42%. Nominal rates rose, except for 28 days. 30 year rates rose. The US\$ strengthened 4.59% against the peso. In the US: Nasdaq, DJ and S&P500 fell. Nominal and real rates fell over all terms. WTI oil price was down 13.19%. Regarding the business climate according to Banxico, optimism fell to 21% (previous 25%), no change rose to 62% (56%), and pessimism fell to 18% (19%).

Mexico					
Stock market and oil					
	28-Feb-20	31-Jan-20	Month	YTD	2019
IRT	58,173.22	62,082.53	-6.30%	-5.05%	7.92%
BMA RT	901.89	960.83	-6.13%	-4.67%	8.97%
FIBRAS BVM RT	331.38	339.81	-2.42%	-0.11%	42.34%
Local currency (USD/MXN)	19.78	18.91	4.59%	4.83%	-4.00%
Mexican oil mix (USD/bbl)	39.76	48.15	-17.42%	29.18%	25.62%
Nominal rates					
	28-Feb-20	31-Jan-20	Month	YTD	2019
CETES 28	7.07%	7.28%	-20 bps	-22 bps	-112 bps
CETES 360	6.55%	6.54%	1 bps	-16 bps	-179 bps
M5	6.66%	6.51%	15 bps	-9 bps	-177 bps
M10	6.85%	6.62%	23 bps	-1 bps	-180 bps
M30	7.16%	6.92%	26 bps	-1 bps	-170 bps
Real rates					
	28-Feb-20	31-Jan-20	Month	YTD	2019
UDIBONDO 10	3.16%	3.24%	-8 bps	-23 bps	-72 bps
UDIBONDO 30	3.35%	3.30%	5 bps	-10 bps	-67 bps
Commodities					
	28-Feb-20	31-Jan-20	Month	YTD	2019
Gold	1,586.97	1,588.15	0.05%	4.39%	18.70%
WTI (USD/bbl)	44.76	51.56	-13.19%	-26.70%	36.63%
UMS					
	28-Feb-20	31-Jan-20	Month	YTD	2019
UMS 10 years	2.54%	2.72%	-18 bps	-65 bps	-173 bps
UMS 20 years	4.01%	3.97%	4 bps	-11 bps	-166 bps
UMS 30 years	4.41%	4.48%	-6 bps	-19 bps	-123 bps
Stock markets (US\$)					
	28-Feb-20	31-Jan-20	Month	YTD	2019
MSCI Developed	9,086.79	9,921.11	-8.41%	-8.94%	28.40%
MSCI Emerging	2,322.26	2,451.39	-5.27%	-9.68%	18.90%
MSCI Mexico	8,120.72	9,021.82	-9.99%	-8.76%	11.77%
MSCI Brazil	6,451.48	7,413.44	-12.98%	-19.47%	26.66%
US					
Stock market					
	28-Feb-20	31-Jan-20	Month	YTD	2019
DJ	25,409.36	28,258.03	-10.07%	-10.98%	22.34%
S&P	2,954.22	3,225.52	-8.41%	-8.56%	28.88%
Nasdaq	8,567.37	9,150.94	-6.38%	-4.52%	35.23%
Nominal rates					
	28-Feb-20	31-Jan-20	Month	YTD	2019
Tbill 90	1.27%	1.55%	-28 bps	-28 bps	-90 bps
Tnote 5	0.89%	1.32%	-43 bps	-60 bps	-62 bps
Tnote 10	1.13%	1.51%	-38 bps	-79 bps	-77 bps
Tbond 30	1.65%	1.99%	-34 bps	-74 bps	-59 bps
Real rates					
	28-Feb-20	31-Jan-20	Month	YTD	2019
Tip 5	-0.44%	-0.28%	-16 bps	-45 bps	-99 bps
Tip 10	-0.28%	-0.14%	-14 bps	-43 bps	-83 bps
Tip 30	0.24%	0.26%	-2 bps	-34 bps	-63 bps
Bank of Mexico survey					
Indicator	2020	2020 anterior			
PIB	0.91%	1.00%			
Inflation	3.52%	3.50%			
Cetes 28	6.45%	6.51%			
Local currency	19.57	19.68			
Business conditions					
	28-Feb-20	31-Jan-20			
Optimism	21%	25%			
No change	62%	56%			
Pessimism	18%	19%			

Source: Bloomberg, Bank of Mexico

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