

# Indignation and uncertainty

## Portfolio Management team



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### Franklin Templeton Servicios de Asesoría 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

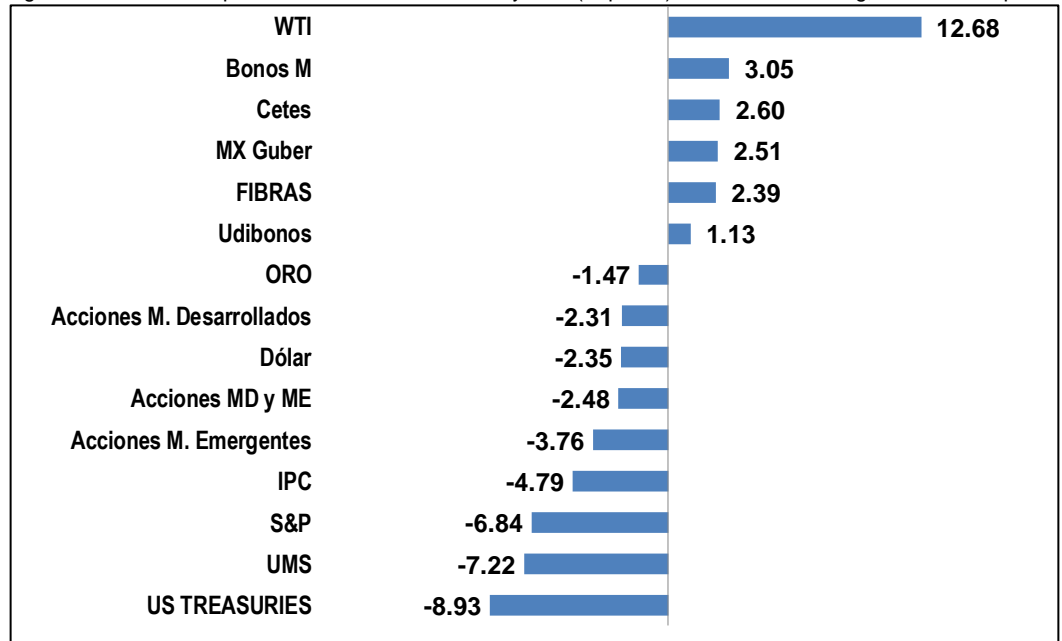
- Globally, US rate increases strengthened the US\$ and lower production raised oil prices. Trade negotiations continue with China. The outlook for Korea seems better, and, for Iran, worse.
- In Mexico, global factors affect investments, but are overshadowed by NAFTA renegotiation, and, 47 days prior to elections, the probability of a populist victory.
- Global risks: failure of pro-growth measures in US, trade wars, monetary policy, Europe, geopolitics, cryptocurrencies.
- Local risks: inconclusive NAFTA negotiation before elections, and negative consequences of July elections.
- Investment scenarios for 2018 no change with probabilities: positive (20%), negative (20%), middle (60%).

“There is perhaps no phenomenon which contains so much destructive feeling as moral indignation, which permits envy or hate to be acted out under the guise of virtue” – Erich Fromm

## Oil, geopolitics and elections

In 2018 to May, the best investments measured in pesos were oil (WTI), Mexican debt and REITs (Figure 1). The oil price increase was mainly due to production declines in OPEC countries, Venezuela and Iran. Relative performance of Mexican investments was helped by peso appreciation against the US\$, but stocks reflected election concerns, 45 days after campaigning officially began on April 1 (Figure 1).

Figure 1. Investments: performance 31Dec2017- 7May2018 (% pesos). Source: Bloomberg, Franklin Templeton



**POLITICS**

**GLOBAL**

**Oil**

The oil price rose above US\$70, a level last reached in November 2014. US production, particularly shale, is at record levels (Figure 2). But OPEC has cut supply, with no clear signals of whether it wishes to limit the price rise. Venezuela’s daily production fell owing to its economic and political crisis (Figure 3).

Figure 2. Oil production US and WTI price (7May18)

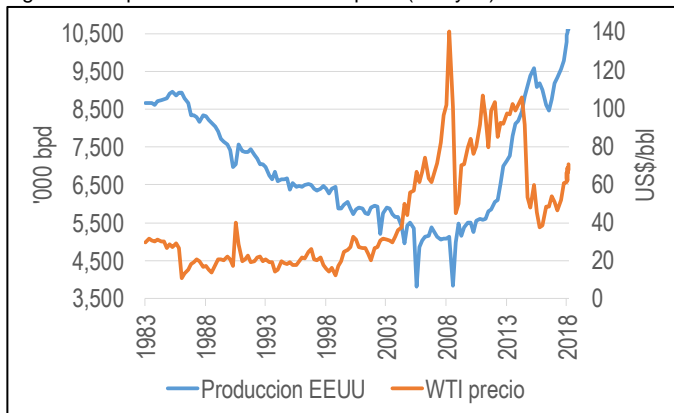
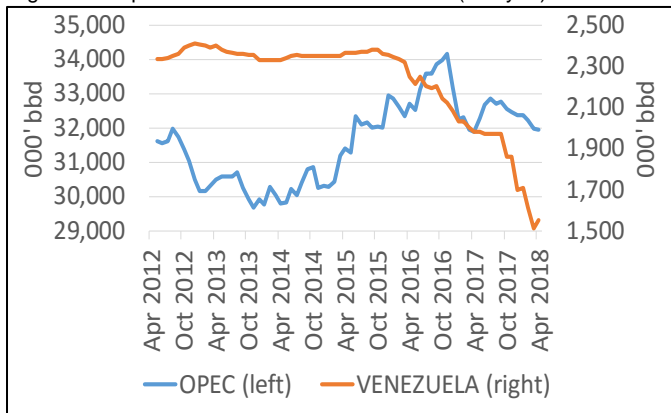


Figure 3. Oil production: OPEC and Venezuela (7May18) Source: Bloomberg



Another factor that contributed to the oil price rise was that Israel revealed that it had conclusive proof that Iran was hiding its nuclear armament activities. On May 8, President Donald Trump announced his withdrawal from the Iran nuclear agreement, which had been reached by Obama in 2015. The US government will immediately prepare to reestablish and increase the economic sanctions that were in force previously. The Iran nuclear agreement had been signed with the US, China, France, UK, Russia and Germany. Other signatories to the agreement have still to decide if they wish to sign its renewal.

**North Korea**

On May 7, North Korea President Kim Jong Un met with China President Xi Jinping to discuss diplomatic progress, their second meeting in less than 2 months. Jong Un informed Jinping of his decision to interrupt nuclear tests, intercontinental missile launches, and the dismantlement of nuclear testing zones. He had already informed South Korea of this decision in April. Jong Un said that the nuclear program would only end if all countries involved stop their hostile policies and threats against his country. A meeting is scheduled for Trump and Jong Un on June 12.

**US**

**Trade negotiations with China**

During March and April tariffs were introduced between the US and China, setting off a trade dispute. Beginning May, US government representatives, (including Wilbur Ross, Commerce Secretary, Steven Mnuchin, Treasury Secretary, and Robert Lighthizer, Trade Representative) went to China to begin negotiations. They delivered a series of demands to China, including:

- Reduction of US trade deficit by US\$200bn. by 2020: US\$100bn. in 2018 and US\$100bn. in 2019.
- Elimination of specific technology transfer policies and practices by China by January 2019.
- Immediate and verifiable measures to guarantee stoppage of Chinese hacking of US commercial networks and cybertheft of intellectual property and commercial information of US companies.
- Reduction by China of tariffs on products in noncritical sectors which do not exceed their equivalents in US, by July 2020.

The meetings ended without an agreement. A second meeting to continue negotiations is expected in mid-May when Chinese representatives will go to Washington.

**Trade negotiations with EU**

During March, the US introduced tariffs of 25% on steel and 10% on aluminum imports. Subsequently the measure was postponed to May 1 for imports from Argentina, Australia, Brazil, Canada, South Korea, Mexico and the EU. On May 1, they were postponed again until June 1. The US has now reached agreements with Argentina, Australia,

Brazil and South Korea to permanently suspend steel tariffs. The President of the European Parliament, Antonio Tajani, has requested that Trump remove tariffs against the EU, with the threat of countervailing measures.

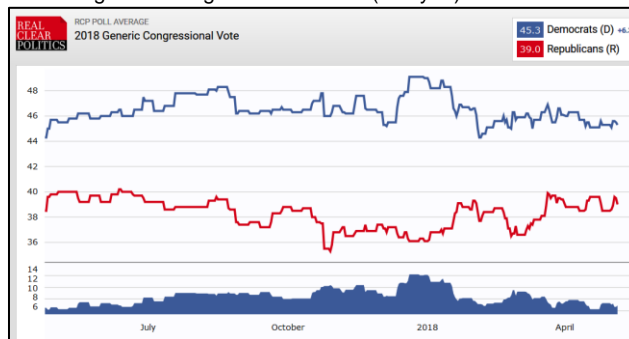
**NAFTA**

On May 7, delegations from Mexico, US and Canada met to continue renegotiating NAFTA, particularly on rules of origin for the auto industry. The US proposes 75% regional content for vehicles assembled in North America. In addition it proposes that 40% of light vehicles and 45% of pickups be assembled in regions with minimum salaries equivalent to US\$167hour or more. Mexico presented a counterproposal with a different and more “conceptual” method of calculating rules of origin instead of using specific percentages, reducing regional content to a maximum of 70%. Mexican representatives expressed confidence that this counterproposal should unblock negotiations which they hope will be concluded by the end of May. Other topics to negotiate remain: dispute resolution, the NAFTA expiration and renovation clause every 5 years, and seasonality in agricultural products. It seems that, owing to the US legislative calendar, the deadline for negotiations is May 31.

**Domestic politics**

In polls for elections scheduled for November 6 (all House, 34% Senate, 34 of 50 state governors, some localities), Republicans are behind: it is unclear whether they will lose majorities in House and Senate (Figure 4).

Figure 4. US Congress: voting intentions 2018 (4May18). Source: RealClearPolitics

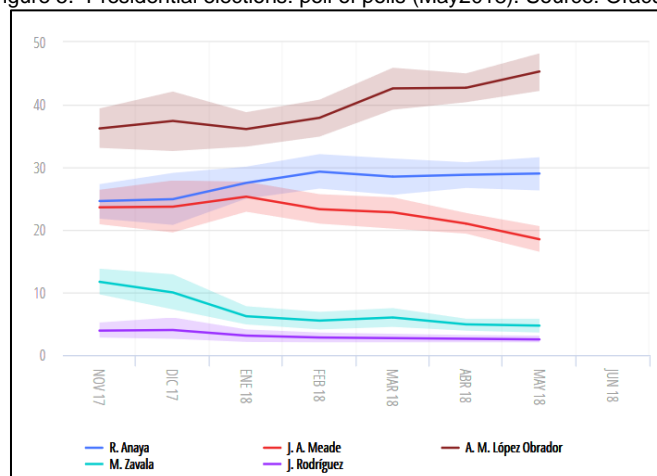


**MEXICO Elections 2018**

*First debate*

The first presidential debate was on April 22, with an estimated viewership of half the voting population. According to most post-debate polls, Ricardo Anaya (PAN) won. However, this did not affect the gap in the polls between first place (Andrés Manuel López Obrador - AMLO) and second, Anaya (Figure 5). The third place PRI candidate, José Antonio Meade, lost ground. With a clearer definition of the top two places, the use of tactical voting currently looks more likely.

Figure 5. Presidential elections: poll of polls (May2018). Source: Oraculus



Polls indicate that indignation against corruption and violence, which are attributed to the current “system” (of parties and oligocracy) weigh more than provable social, economic and educational improvement. This perception, amplified by social networks, is the same as that which has produced the populism which caused Brexit in the UK, the election of Trump in the US, and the advance of populist parties in Europe. The issue is whether Mexico can be an exception to this global populist trend.

*Second debate*

The second debate is scheduled for May 20 covering trade, investment and migration, with audience participation. Some consider this the most important in a world that is more globalized than ever, NAFTA negotiations, and the large number of Mexican migrants in the US (Figure 6).

Figure 6. Mexico: 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 Frontier security and fighting
Universidad Autónoma 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

At the beginning of May, after members of the Businessmen’s Coordinating Council (Consejo Coordinador Empresarial) met with Anaya to discuss his campaign proposals, AMLO criticized them saying that they “did not want to stop stealing” and accusing them of being the cause of his presidential election loss in 2006. In response, several businessmen have publicly united against him. AMLO has moderated his tone and, in the second week of May, a document entitled “Pejenomics” (after “Peje”, his nickname) was published, where AMLO explains that his criticism is directed against a small group, not the “enormous majority”, of businessmen.

**ECONOMY  
GLOBAL**

Global growth is estimated for 2018, with slight slowdown in 2019, mainly for DM (Figure 7).

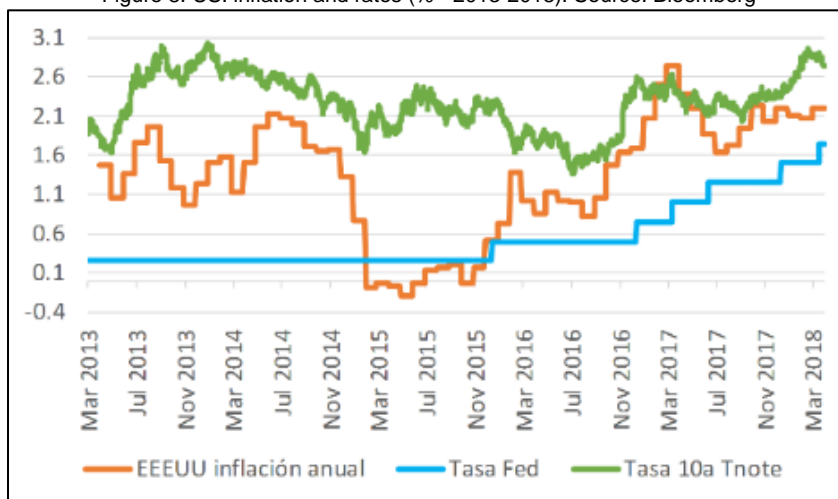
Figure 7. DM and EM: estimated growth 2017- 2019 (May2018) Source: Bloomberg

Developed markets				Emerging markets			
Growth(%)	2019 E			2019 E			
	2019 E	2018 E	2017 E	2019 E	2018 E	2017 E	
World	3.70	3.70	3.60	World	3.70	3.60	
Developed	2.18	2.44	2.36	Emerging	5.10	4.57	
US	2.50	2.80	2.30	China	6.30	6.90	
Euro Area	1.96	2.30	2.50	India	7.40	6.30	
Japan	1.00	1.30	1.60	Rusia	1.80	1.50	
Britain	1.50	1.50	1.70	Brasil	2.77	1.00	
Australia	2.80	2.70	2.30	México	2.40	2.10	
Canada	1.90	2.10	2.95	Corea del sur	2.80	3.20	
Germany	1.90	2.40	2.50	Indonesia	4.05	5.10	
France	1.80	2.10	1.90	Turquia	4.05	6.80	

**US  
Fed rates**

The Fed decided to leave unchanged its reference rate at the 1.5-1.75% range (Figure 8). Analysts expect that the second increase this year will occur in its June meeting. Fed President Jerome Powell mentioned that market projections are aligned with the FOMC’s view. He does not consider that rate rises are a risk for EM flows.

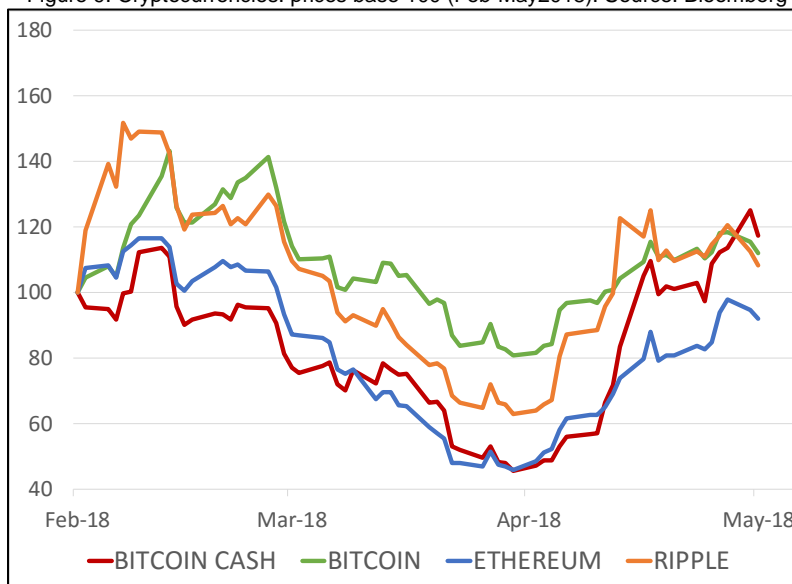
Figure 8. US: inflation and rates (% - 2013-2018). Source: Bloomberg



### Cryptocurrencies

Since Satoshi Nakamoto invented Bitcoin in 2008 as an alternative to financial crisis, it reached its all-time high in December 2017, since when it has fallen 51%. There are currently four cryptocurrencies with a market capitalization of more than US\$20bn.: Bitcoin (\$151bn.), Ethereum (\$64bn.), Ripple (\$34bn.) and Bitcoin Cash (\$24bn.). Most cryptocurrencies are correlated, although there seems to be no fundamental cause. In April, there were average rises of 90% (Figure 9).

Figure 9. Cryptocurrencies: prices base 100 (Feb-May2018). Source: Bloomberg



After its initial popularity, the number of daily Bitcoin trades has fallen to a two year low. The main reason is regulation. In January 2017, 93.2% of Bitcoin trades were in China. After regulatory measures were announced by the Chinese government in 2017, 80% of trades are now in Japan and the US. Trades are expected to diminish, as regulations are introduced in other countries. While Bitcoin has the largest highest market capitalization of cryptocurrencies it is one of the least efficient, with one trade taking up to 40 minutes.

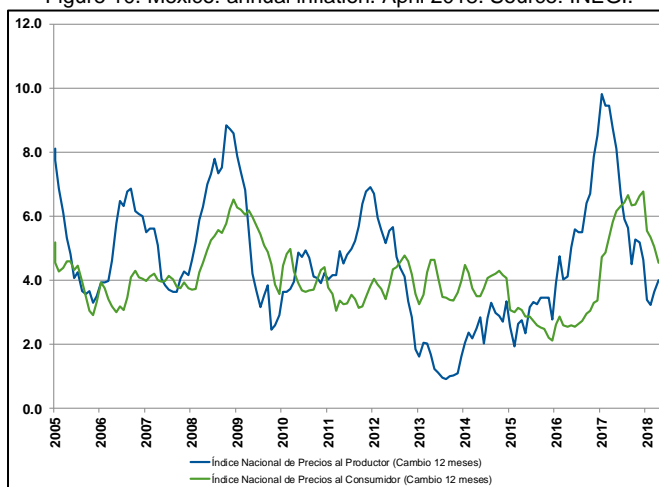
Ripple is a different cryptocurrency. It has become popular because it is issued, not mined, and trades can be made in 40 seconds. Ripple is working with banks and regulators to improve settlement and transfer systems. It has so far signed agreements with 100 banks, including Santander. In April it was announced that a George Soros fund will invest in cryptocurrencies. In this he is joining other well-known people who have spoken against cryptocurrencies but nonetheless invested in them. Owing to their volatility cryptocurrencies do not work as currencies but more like commodities to diversify portfolios.

**MEXICO**

**Inflation**

In April, the CPI fell from 5.04% to 4.55%, a 16 month low. The PPI rose from 3.64% to 4.00% (Figure 10).

Figure 10. Mexico: annual inflation. April 2018. Source: INEGI.



**RISKS AND SCENARIOS 2018**

Considering foreseeable risks, we present 3 investment 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).

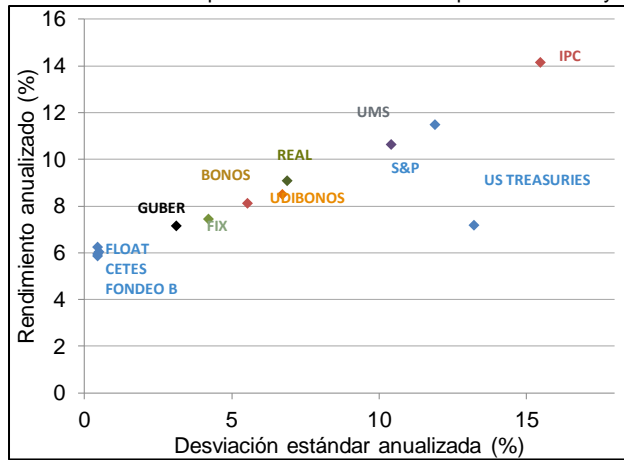
<b>RISKS</b>	
<p><i>Global</i></p> <ul style="list-style-type: none"> <li>• EEUU: Trump progrowth initiatives, trade wars</li> <li>• Europe: Brexit, Catalonia and elections (Italy)</li> <li>• Geopolitics: Middle East, Russia, China, North Korea</li> <li>• Global slowdown, monetary policy</li> <li>• Bitcoin</li> </ul> <p><i>Mexican</i></p> <ul style="list-style-type: none"> <li>• Elections 2018</li> <li>• NAFTA renegotiation</li> <li>• Security</li> <li>• Corruption</li> <li>• Oil price</li> <li>• Debt increase: credit rating</li> </ul>	
<b>SCENARIOS</b>	
<p><i>Positive (20%)</i></p> <ul style="list-style-type: none"> <li>• US: tax reduction, deregulation and infrastructure Investment, absence of trade wars.</li> <li>• Europe, China, Russia, Korea and Middle East: risks do not materialize.</li> <li>• Global synchronous growth, successful monetary policy.</li> <li>• Bitcoin crash does not affect economy.</li> <li>• Mexico: positive elections, NAFTA renegotiation "win-win", corruption and security risks contained.</li> </ul> <p><i>Negative (20%)</i></p> <ul style="list-style-type: none"> <li>• US: progrowth policies fail, trade wars break out.</li> <li>• Europe (UK and EU) disintegrates, risks in China, Russia, Korea and Russia materialize.</li> <li>• Global slowdown due to politics, economic dynamics, or monetary policy.</li> <li>• Bitcoin crash affects economy.</li> <li>• Mexico: negative elections, NAFTA renegotiation fails, corruption and insecurity increase.</li> </ul> <p><i>Middle (60%)</i></p> <ul style="list-style-type: none"> <li>• US progrowth measures partially successful, mixed trade measures.</li> <li>• Europe, China, Russia, Korea and Middle East: risk materialize partially.</li> <li>• Global growth continues, less synchronized than 2017 and monetary policy partially successful.</li> <li>• Bitcoin crash partially affects economy.</li> <li>• Mexico: uncertain elections, TLC renegotiation partially positive, corruption and security partially contained.</li> </ul>	

**MARKETS**

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

Despite peso depreciation, long term (2000-2018) peso denominated investments have outperformed US\$ denominated investments converted to pesos (Figure 11).

Figure 11. US\$ and peso-denominated investments: performance measured in pesos 2000-May2018. Source: Franklin Templeton



**US\$ and peso**

The US\$ has strengthened against other currencies owing to the possibility of more aggressive interest rate hikes by the Fed. The sharp appreciation could generate important capital flows from EM. The presidential debates and polls do not seem to have significantly affected the peso-US\$ rate (Figures 12 and 13).

Figure 12. US\$ index and peso 2005-May2018. Source: Bloomberg

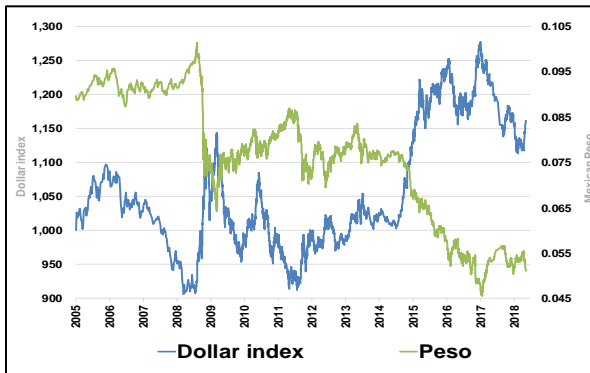
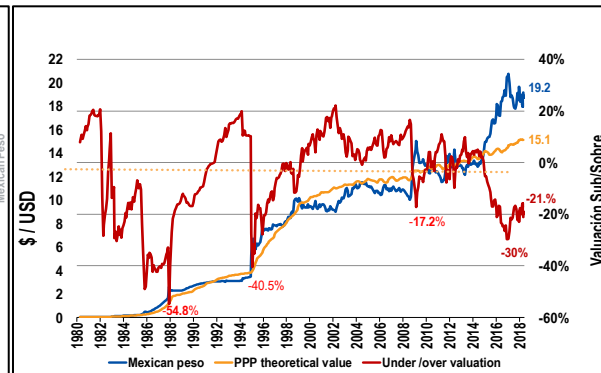


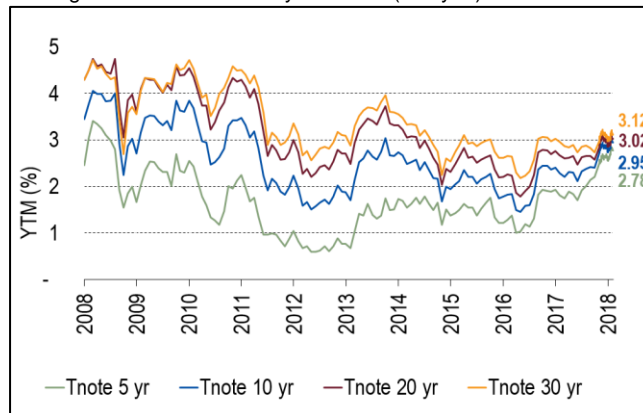
Figure 13. Peso vs. US\$: 1980-May2018. Source: Franklin Templeton



**Debt**

US rates rose during April over all terms. The Fed has said that inflation is increasing and that this could imply a more aggressive rhythm in the normalization of monetary policy (Figure 14).

Figure 14. US: historical yield curve (8May18). Source: Fed



The market still expects rates to rise in most DM, and to fall in most EM (Figure 15).

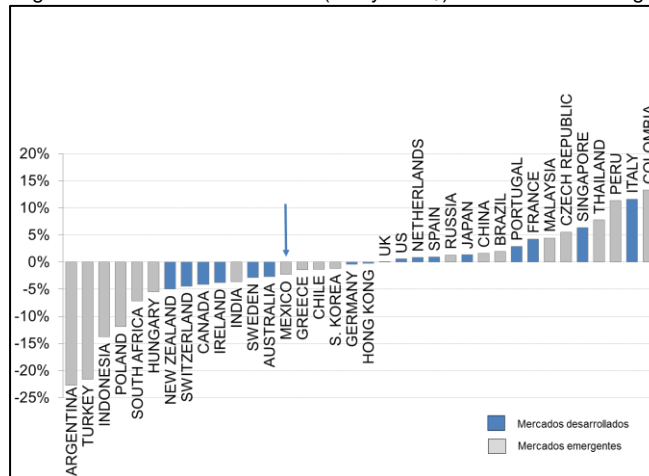
Figure 15. DM and EM: 10 year rates estimated for end-2018 (4May2018). Source: Bloomberg, Franklin Templeton

Developed				Emerging			
	local 10y yields (%)				local 10y yields (%)		
	4Q18e	Actual	Aumento (bps)		4Q18e	Actual	Aumento (bps)
US	3.12	2.95	17	China	3.70	3.66	4
Euro Area	0.95	0.53	42	India	7.52	7.62	(10)
Japan	0.13	0.04	9	Rusia	7.27	7.18	9
Britain	1.81	1.40	41	Brasil	9.47	9.92	(45)
Australia	3.02	2.74	28	México	7.50	7.66	(16)
Canada	2.59	2.33	26	Corea del sur	2.72	2.76	(4)
Germany	0.95	0.53	42	Indonesia	6.75	7.16	(41)
France	1.40	0.77	63	Turquia	12.08	13.92	(184)

**Stocks**

During 2018 stock markets have been affected by various factors: rate rises, trade wars, possible regulation of tech companies and geopolitics. Good 1Q reports were expected and they were even better, especially tech companies, despite regulation fears. Tax reform helped as did US\$ weakness for multinationals. EM which received substantial flows in 1Q2018 have also seen a reduced dynamism in April. The Mexican market has followed global trends, but is particularly affected by the peso/US\$ parity (Figure 16).

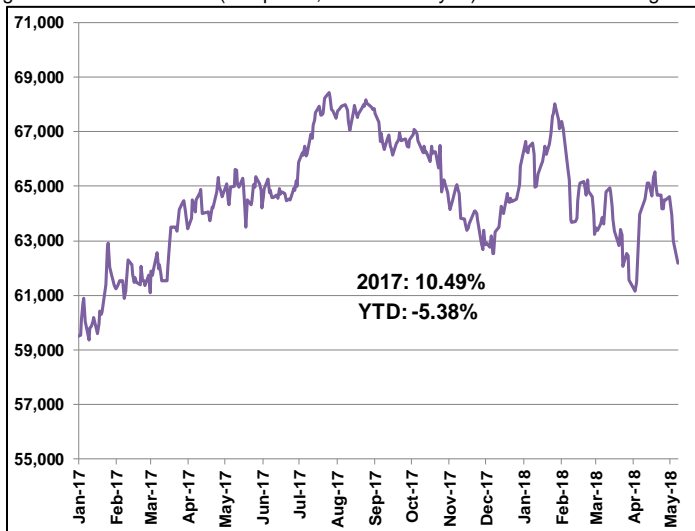
Figure 16. Stock markets: 2018 (7May - US\$). Source: Bloomberg



In Mexico (Figure 17) and the US (Figure 18), volatility is higher than 2017 but historically normal.

Figure 17. Mexico: stocks (IRT pesos, 1Jan17-7May18). Source: Bloomberg

Figure 18. US: stocks (S&P500 US\$, 1Jan17-7May18). Source: Bloomberg





### REITs (Fibras)

Due to novelty, high dividends, and inflation protection, REITs have performed better than stocks since 2011. Since Trump’s election in November 2016, REITs have been hit by increased uncertainty over NAFTA renegotiation, the political outlook, and recently fears about inflation and trade wars. There has been a recent improvement owing to better NAFTA prospects (Figures 19 and 20).

Figure 19. Fibras vs. Mexican stocks (IRT) Mar2011-7May2018 (base 100 MXN\$). Source: Bloomberg

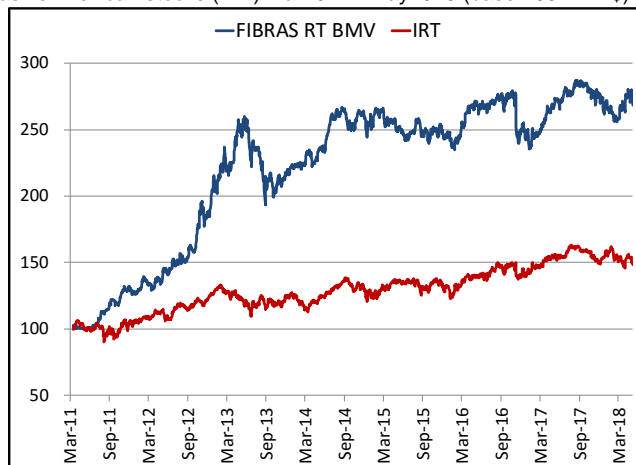


Figure 20. Fibras: valuation and dividends (7May2018). Source: Franklin Templeton

	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%	

New issues are expected, specializing in hotels (FSTAY), universities, and the shared economy, more issues of FIBRA E, specialized in prisons and another in hydraulic projects, all before the elections.

### Conclusion

Despite important global factors, the rise in interest rates, the possibility of trade wars between the US and China and Europe, and geopolitical situations in Iran and North Korea, Mexico is still mainly focused on NAFTA renegotiation and, most importantly, the critical July 1 elections. For peso denominated portfolios, overweight ILS with 1-3 year duration and underweight stocks and REITs.

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**Editor: Timothy Heyman**  
**May 14, 2018**

**Main financial indicators: monthly at April 30, 2018**

During April, In Mexico, the IPC rose 4.84%. Nominal rates rose for medium and long terms. Real rates rose for 10y. The US\$ rose 2.83% vs. the peso. In the US, the DJ, S&P500 and Nasdaq rose. Nominal rates rose for all terms, and real rates fell for 30y. In the Banxico business climate poll, optimism rose to 19% (16% previous), no change fell to 44% (50%), and pessimism rose to 38% (34%).

Mexico					
<b>Stock market and oil</b>					
	30-Apr-18	28-Mar-18	Month	YTD	2017
IPC	48,358.16	46,124.85	4.84%	-2.02%	8.13%
Local currency (USD/MXN)	18.79	18.27	2.83%	-4.45%	-4.64%
Mexican oil mix (USD/bl)	61.35	56.9	7.82%	9.18%	21.36%
<b>Nominal rates</b>					
	30-Apr-18	28-Mar-18	Month	YTD	2017
CETES 28	7.56%	7.56%	0 bps	24 bps	148 bps
CETES 360	7.52%	7.59%	-7 bps	6 bps	103 bps
M5	7.35%	7.20%	15 bps	-24 bps	38 bps
M10	7.49%	7.33%	16 bps	-16 bps	15 bps
M30	7.67%	7.63%	4 bps	-11 bps	-4 bps
<b>Real rates</b>					
	30-Apr-18	28-Mar-18	Month	YTD	2017
UDIBONO 10	3.64%	3.63%	1 bps	14 bps	45 bps
UDIBONO 30	3.85%	3.86%	-1 bps	15 bps	-9 bps
<b>Commodities</b>					
	30-Apr-18	28-Mar-18	Month	YTD	2017
Gold	1,315.39	1,325.01	-0.73%	0.97%	12.48%
WTI (USD/bl)	61.35	56.9	7.82%	9.18%	4.60%
<b>UMS</b>					
	30-Apr-18	28-Mar-18	Month	YTD	2017
UMS 10 years	4.43%	4.15%	28 bps	80 bps	-64 bps
UMS 20 years	5.16%	5.01%	16 bps	63 bps	-74 bps
UMS 30 years	5.12%	4.96%	17 bps	48 bps	-62 bps
<b>Stock markets (US\$)</b>					
	30-Apr-18	28-Mar-18	Month	YTD	2017
MSCI Developed	8,470.21	8,290.63	2.17%	0.05%	23.07%
MSCI Emerging	2,547.86	2,539.39	0.33%	1.04%	37.75%
MSCI Mexico	9,700.70	9,461.02	2.53%	3.20%	16.27%
MSCI Brazil	6,841.30	6,976.43	-1.94%	7.99%	24.48%

US					
<b>Stock market</b>					
	30-Apr-18	28-Mar-18	Month	YTD	2017
DJ	24,163.15	23,848.42	1.32%	-2.25%	25.08%
S&P	2,648.05	2,605.00	1.65%	-0.96%	19.42%
Nasdaq	7,066.27	6,949.23	1.68%	2.36%	28.24%
<b>Nominal rates</b>					
	30-Apr-18	28-Mar-18	Month	YTD	2017
Tbill 90	1.87%	1.73%	14 bps	60 bps	76 bps
Tnote 5	2.79%	2.59%	20 bps	65 bps	21 bps
Tnote 10	2.95%	2.77%	18 bps	53 bps	-3 bps
Tbond 30	3.11%	3.01%	10 bps	28 bps	-23 bps
<b>Real rates</b>					
	30-Apr-18	28-Mar-18	Month	YTD	2017
Tip 5	0.69%	0.68%	1 bps	43 bps	17 bps
Tip 10	0.78%	0.72%	6 bps	31 bps	-3 bps
Tip 30	0.91%	0.94%	-3 bps	19 bps	-27 bps

Bank of Mexico survey		
Indicator	2018	2018 anterior
PIB	2.21%	2.21%
Inflation	3.98%	4.07%
Cetes 28	7.42%	7.47%
Local currency	18.83	18.84
<b>Business conditions</b>		
	30-Apr-18	28-Mar-18
Optimism	19%	16%
No change	44%	50%
Pessimism	38%	34%

Source: Bloomberg, Banco de Mexico

**IMPORTANT LEGAL INFORMATION**

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