Templeton Dragon Fund Inc

TDF | **Commentary | as of December 31, 2025**

Key Takeaways

- **Markets:** Chinese equities, after collectively posting three straight quarters of gains, ended the final quarter of 2025 with a decline. Chinese equities came under pressure after the Politburo signaled a more restrained approach for its stimulus in 2026.
- **Contributors:** Stock selection in the information technology, industrials and consumer discretionary sectors were accretive to returns relative to the benchmark MSCI China All Shares Index-NR. An underweight allocation in information technology supported relative strength further.
- **Detractors:** An underweight allocation in the energy sector and a lack of exposure to the utilities sector combined with stock selection in the financials sector to detract relatively.
- **Outlook:** China is at an interesting point in the equity market cycle. Following a prolonged period of underperformance relative to developed markets, investor sentiment has turned generally positive as government policy has pivoted to be stimulative. However, we have yet to see economic growth recover. This has led to a disconnect in the market between sentiment and fundamentals; we believe it is also one where we can add value—a stockpicker's market.

Performance Review

- Harbin Electric is a manufacturer of power generation equipment. Its share price advanced in a sectoral movement of nuclear power stocks. Its share price tracked higher as investor optimism over China's electricity demand emerged. The growth in artificial intelligence (AI) data centers, electrification and electricity exports underpin this demand. Subsequently, a data-center power shortage also contributed to some share-price gains. Harbin Electric is strategically positioned within China's energy transition plans, leveraging its legacy in coal-fired equipment while expanding into nuclear, hydro, and clean technologies. In addition, we believe Harbin Electric offers a valuation discount relative to its peers, making it an attractive play on China's long-term energy infrastructure growth.
- Sieyuan Electric is a company that specializes in the research and development, production, sale, and service of power transmission and distribution equipment in China and internationally. Its share price rose on its stellar third-quarter results. It showcased improved cash flow and fairly stable gross profit margins, and highlighted strong order growth. With rising renewable energy installations, increasing electrification in many industries, and growing power consumption demand from AI that drives load growth in power systems, we believe global grid infrastructure is entering an upwards capital expenditure (capex) cycle that is likely to extend to 2030. In our view, Sieyuan Electric, with its strong research and development capability and solid track record, is well-positioned to benefit from the capex cycle in both China and abroad.
- Xiaomi is a China-based consumer electronics, software and hardware designer. While third-quarter results were resilient, investor concerns over potential near-term business weakness due to pressures on smartphones and appliances alongside a delay in its electric vehicle (EV) capacity ramp-up.

Outlook

- China is at an interesting point in the equity market cycle. Following a prolonged period of underperformance relative to developed markets, investor sentiment has turned generally positive as government policy has pivoted to be stimulative. However, we have yet to see economic growth recover. This has led to a disconnect in the market between sentiment and fundamentals; we believe it is also one where we can add value—a stockpicker's market.
- We see several themes that didn't exist a year ago playing out. Anti-involution, which is supply-side reform, is one example. The goal of the Chinese government's anti-involution campaign is to promote industrial consolidation and sustainable growth via rigorous enforcement of regulations. AI is another big theme; in China, the story is about import substitution, using its own data to develop AI models, data centers and innovative services. The buildout in China is as big as that in the United States. Autonomous driving is also an important theme, and we think China may lead the charge, just as it did in EVs.
- Taking a long-term view, valuations of Chinese equities remain attractive. Over the past few years, Chinese stocks have faced significant pressure and have seemed largely overlooked by investors. However, the pivot in policy support appears to have sparked a notable shift in investor sentiment, which is evident among both domestic and foreign investors. In addition to boosting market confidence, investors are also re-evaluating the growth potential of Chinese companies. Valuations, which had been suppressed, are now being reassessed, with many investors recognizing the underlying value and growth prospects.
- Despite continuing volatility, we believe market sentiment toward China has improved. That said, we still approach investing with a well-rounded perspective. We remain cognizant of the key risks in the investment universe, and we are keeping a close eye on geopolitical tensions and government policies. We abide by our bottom-up investment approach and leverage our on-the-ground presence and extensive network for a balanced view. This network goes beyond just companies, channel checks and independent research providers. We continue to keep a watchful eye on changes in the investment environment to identify opportunities.

Top Equity Issuers (Equity as a % of Total)

	Fund
TENCENT HOLDINGS LTD	11.17
ALIBABA GROUP HOLDING LTD	8.83
WUS PRINTED CIRCUIT KUNSHAN CO LTD	4.26
XIAOMI CORP	3.41
PING AN INSURANCE GROUP CO OF CHINA LTD	3.01
CHINA MERCHANTS BANK CO LTD	2.69
HARBIN ELECTRIC CO LTD	2.53
CMOC GROUP LTD	2.40
MIDEA GROUP CO LTD	2.35
SIEYUAN ELECTRIC CO LTD	2.20

Average annual total returns (%) - as of December 31, 2025

Product	Ticker	Listed Exchange	3-Mo*	6-Mo*	YTD*	1-Yr	3-Yr	5-Yr	10-Yr	Inception	Inception Date
Market Price Return	TDF	NYSE	-2.49	14.67	37.67	37.67	5.09	-8.56	4.63	8.08	9/20/1994
NAV Returns	—	—	-3.67	13.84	29.67	29.67	4.48	-7.43	3.81	7.35	9/20/1994
Benchmark	—	—	-4.23	15.36	28.94	28.94	9.90	-2.45	4.14	—	—

*Cumulative total returns

Benchmark(s)

Benchmark =MSCI China All Shares Index-NR

Performance shown represents past performance and is no guarantee of future results. *Current performance may be higher or lower than the performance shown. Investment return and principal value will fluctuate so shares, when sold, may be worth more or less than the original cost. Returns based on Market Price or NAV, and assume the reinvestment of all distributions at the Dividend Reinvestment Plan Price or NAV, respectively. All returns include the deduction of management fees, operating expenses and all other fund expenses, and do not reflect the deduction of brokerage commissions or taxes that investors may pay on distributions or the sale of shares. When applicable, performance would have been lower if fees had not been waived in various periods. An investor cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expense or sales charges. Returns for periods of less than one year are not annualized. Please visit franklintempleton.com for the most recent month-end performance.*
Gross expenses are the fund's total annual operating expenses as of the fund's annual report available at the time of publication. Actual expenses may be higher and may impact portfolio returns. Net expenses reflect voluntary fee waivers, expense caps and/or reimbursements. Voluntary waivers may be modified or discontinued at any time without notice.

What are the Risks?

All investments involve risks, including possible loss of principal. International investments are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in **emerging markets.** There are special risks associated with investments in **China, Hong Kong and Taiwan**, including less liquidity, expropriation, confiscatory taxation, international trade tensions, nationalization, and exchange control regulations and rapid inflation, all of which can negatively impact the fund. Investments in Hong Kong and Taiwan could be adversely affected by its political and economic relationship with China. To the extent the fund invests in companies in a specific **country or region,** the fund may experience greater volatility than a fund that is more broadly diversified geographically. The portfolio is **non-diversified** and may invest in a relatively small number of issuers, which may negatively impact the fund's performance and result in greater fluctuation in the value of the fund's shares. The managers' **environmental social and governance (ESG) strategies** may limit the types and number of investments available and, as a result, may forgo favorable market opportunities or underperform strategies that are not subject to such criteria. There is no guarantee that the strategy's ESG directives will be successful or will result in better performance.

Glossary

Capital Expenditure (capex) are funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment.

Important Information

The information provided is not a complete analysis of every material fact regarding any country, market, industry, security or fund. Because market and economic conditions are subject to change, comments, opinions and analyses are rendered as of the date of this material and may change without notice. A portfolio manager's assessment of a particular security, investment or strategy is not intended as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy; it is intended only to provide insight into the fund's portfolio selection process. Holdings are subject to change.

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The **MSCI China All Shares Index-NR** captures large- and mid-cap representation across China A-shares, B-shares, H-shares, Red-chips, P-chips and foreign listings (e.g., ADRs). The index aims to reflect the opportunity set of China share classes listed in Hong Kong, Shanghai, Shenzhen and outside of China.

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