FRANKLIN TEMPLETON INVESTMENTS

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PERSPECTIVES

Dividend-Paying Equities Remain Attractive

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Myriad global concerns have stirred up financial markets over the past several years. Volatility may have become a new norm, bringing many changes to the investment landscape. Amid bouts of widespread uncertainty, many investors committed their assets to the bond market. Recently, however, we have seen increased interest in equities. One segment of the market that remains particularly compelling, in our view, is dividend-paying stocks.

Low, long-term interest rates continue to drive new issuance activity in credit markets, as companies extend maturities and refinance at lower debt costs. Both yields and credit spreads have contracted across fixed income markets, driving prices higher and reducing the potential for longer-term total return.

Meanwhile, many developments have made investments in stocks, especially dividend payers, more attractive. Corporate fundamentals remain favorable, with companies reporting record earnings and generating healthy cash flows. Companies have continued to enhance shareholder value through increased share repurchases and higher dividend payouts. Though equity markets are higher, we believe valuations in the market are currently attractive according to various metrics such as price/earnings, enterprise value to EBITDA (earnings before interest, taxes, depreciation and amortization), and free cash flow margin relative to historical levels.

While much has been written on this topic in the recent past, we believe many factors, such as an increasingly diverse array of companies paying dividends, high cash levels on corporate balance sheets in combination with low dividend payouts, generally healthy earnings and consistent cash flows, and a continued search for income among investors, all bode well for dividend-paying stocks.

A Broadening Opportunity Set: More Than Just Utilities

Despite the challenging environment of the past several years, the broad US equity market has generally recovered from its 2009 lows. Many US companies cut costs, improved their operations, and strengthened and recapitalized their balance sheets. Growing cash balances allowed many firms to implement favorable dividend actions, leading to a broad and diverse opportunity set available to dividend-oriented investors.

We continue to see dividend initiations and increases across a range of sectors. Such sectors extend beyond utilities, a space usually considered the staple of dividend investing. In fact, we are seeing initiations and increases in sectors that are historically characterized

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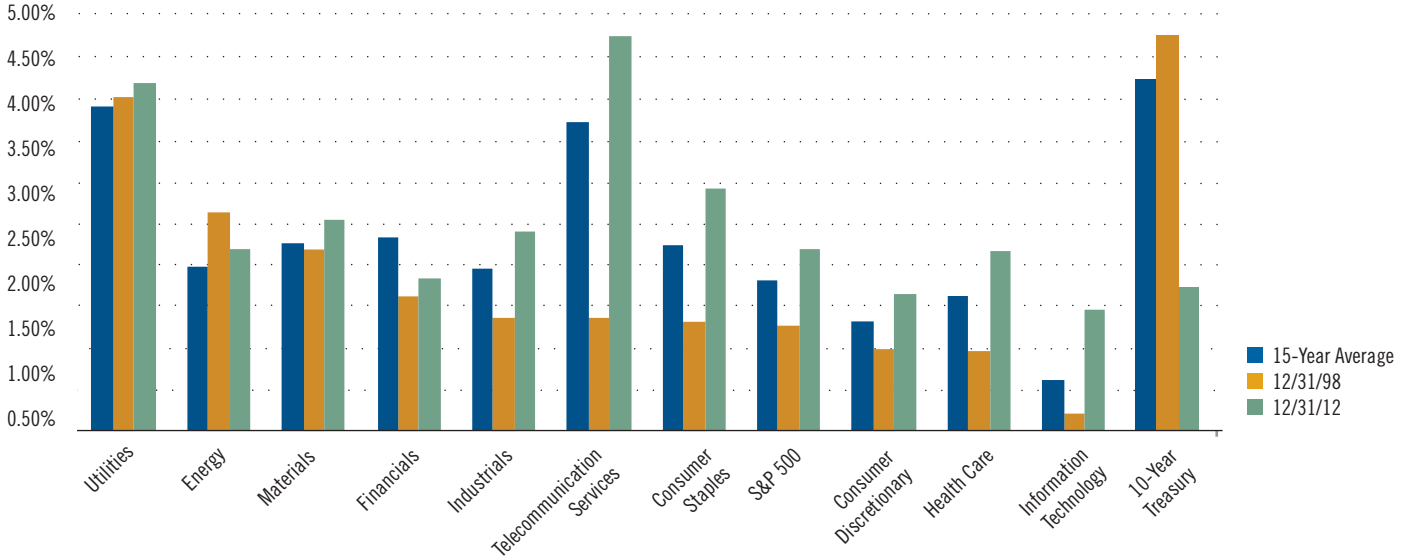
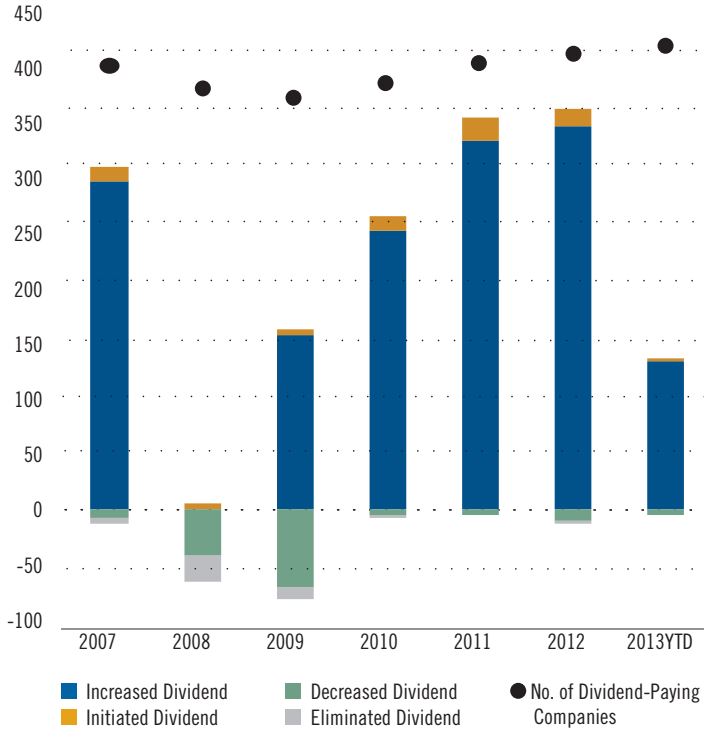
as having weaker dividend profiles, such as information technology. At the end of 2012, most sectors in the S&P 500® Index had higher dividend yields than they had 15 years ago—with dramatic increases in some cases. The chart below shows the sector yields within the S&P 500 Index, illustrating improvements across most sectors since the 2008 financial crisis.

Chart 1: Equity Dividend Yields: Have Moved Higher Over Time
12/31/98 and 12/31/12



Source: FactSet, Federal Reserve, and S&P Data as of 12/31/12. For illustrative purposes only; not representative of any Franklin Templeton funds. One cannot invest directly in an index, nor is an index representative of the fund's portfolio.

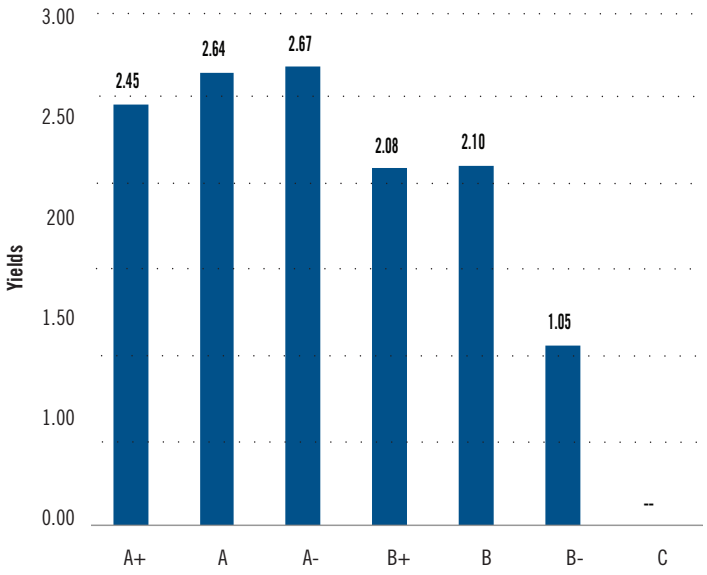
Chart 2: Dividend Policy Changes of Companies within the S&P 500 Index
From 2007 to 2013 (YTD)



Source: S&P Index Data Services, as of 4/15/13. One cannot invest directly in an index, nor is an index representative of the fund's portfolio.

Generally, payment of regular dividends and dividend increases is an indicator of the financial health and ability of a company to weather periods of slow growth or contraction. Dividend-paying companies tend to have a strong financial footing, leading or competitive positions in their industries, and experienced management teams. They often command high or growing market shares, sustainable competitive advantages over their peers, strong margins and stable cash flows. These are some of the characteristics that allow companies to return capital to shareholders in the form of dividends. A solid financial position is also often reflected in investment-grade ratings by credit rating assigned agencies. As seen in Chart 3, high credit-quality companies tend to pay dividends.

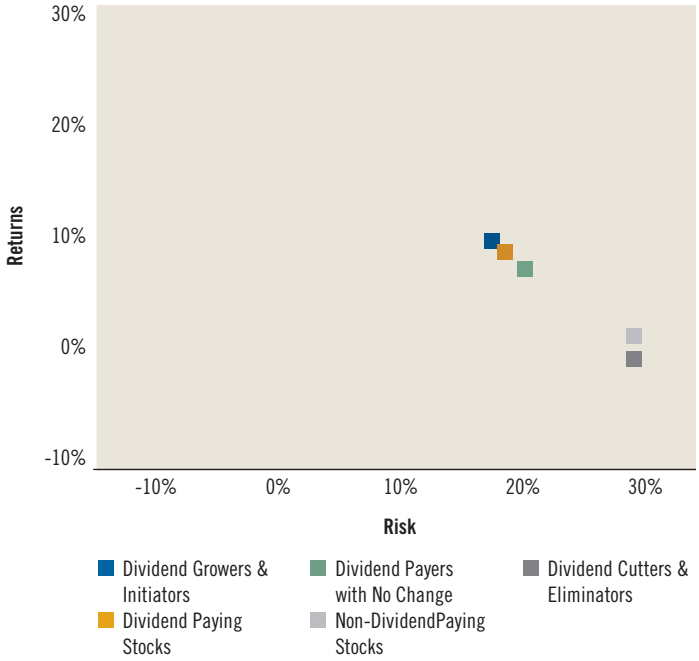
Chart 3: Dividend Yield by S&P Credit Quality Rating
12/31/95 to 12/31/12



Source: FactSet, S&P Data Services.

Historically, dividend payers have outperformed non-dividend payers over the long term, and they have done so with less volatility, as illustrated in the following chart.

Chart 4: S&P 500 Stocks Risk vs. Return by Dividend Policy
From 1/31/72 to 12/31/12



Source: Ned Davis Research Group, Inc.

Past performance is no guarantee of future results. An index is unmanaged, and one cannot invest directly in an index. This chart is for illustrative purposes only and does not represent the performance of any Franklin Templeton fund. One cannot invest directly in an index, nor is an index representative of the fund's portfolio.

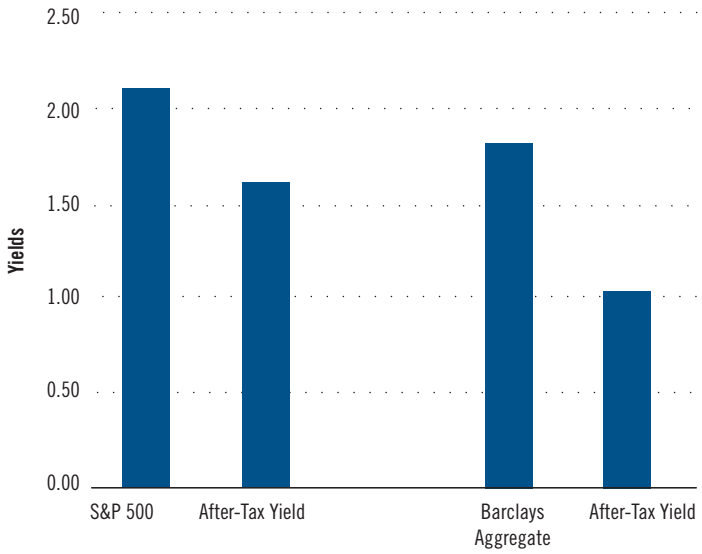
Importance of Dividend Income

Dividends can be an important source of income and total return for investors. This is particularly true now, as yields within fixed income markets have been hovering at historical lows. Moreover, compellingly low interest rates have allowed many companies to refinance their debt at much lower rates and include covenants that may be unfavorable for fixed income investors. Overall, the potential for total return within the fixed income markets has decreased, in our view.

In contrast, yields on dividend-paying equity continue to be attractive relative to yields available in the fixed income markets. With dividend payout ratios at the lower end of the historical range (just over 30% for the S&P 500 Index as of April 30, 2013, compared to historical levels (March 31, 1962 to December 31, 2012) of about 50%), and cash balances at the higher end (S&P 500 Index's cash as percent of total debt stood at 37% as of April 30, 2013), we believe current dividend levels appear sustainable and have room to grow. Moreover, dividend growth may help to support and lift the level of income stream that investors receive when interest rates rise, while the interest paid by bonds is generally fixed.

Another important consideration for income-seeking investors is related to differences in the taxation of dividend income relative to interest income from bonds. While uncertainty surrounding the US budget deficit reduction measures, including the tax increase on dividend income, led to some volatility within dividend-paying equity markets at the end of 2012, the dividend tax increase turned

Chart 5: After Tax Yield Comparison
2/28/13



Source: S&P and Barclays index yields data via FactSet.

Past performance is no guarantee of future results. Indexes are unmanaged, and one cannot invest directly in an index. This chart is for illustrative purposes only and does not represent the performance of any Franklin Templeton fund. One cannot invest directly in an index, nor is an index representative of the fund's portfolio. Both after-tax yield calculations include the 3.8% Medicare surtax for high earners. Tax rates information from the Internal Revenue Service (IRS.gov).

out to be less burdensome than some had been feared. Qualified dividend income is now taxed at a maximum rate of 20% (up from 15%), while interest income from bonds is taxed at the same rate as ordinary income, which may be higher than 20% for most investors. Additionally, qualified dividends became a permanent part of the tax code.

In Our View, Dividend Investing Remains Compelling

While some observers argue that the dividend trade has become overcrowded, the whole segment cannot be described this way. We continue to identify an array of investments in the dividend-paying equities space by scrutinizing individual companies' fundamentals, projecting their growth prospects, and aiming to recognize high-quality stocks that we believe have not been fully rewarded by market participants.

Appendix

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