FRANKLIN TEMPLETON

Frequently asked questions

Franklin Factors US Index

What is the Franklin Factors US Index?

A rules-based index designed to pursue stable growth while managing downside risk with a volatility target of 5% annually. Utilizing a mix of stocks, bonds and cash, the index relies on 2 components to achieve its goal: The Elite Tier Stock Screen and Dynamic Shift Technology.

What exposure does the index provide?

Long-term investment growth is historically optimized by an allocation to equity investments. Over the past 20 years, S&P 500 had average annual volatility of just over 19%.[1] The Franklin Factors US Index is designed to offer as much exposure to the US equity market as possible without exceeding a volatility budget of 5% standard deviation on an annualized basis. Similarly, in low volatility environments, the index is designed to increase its equity exposure in order to use up the 5% volatility budget and to maximize growth opportunities.

What is its asset allocation mix?

The index has a generally unconstrained asset allocation mix. It systematically uses three instruments to generate as much equity exposure as possible within the 5% volatility budget:

- Franklin Diversified US Large Cap Equity Index (TFTDLCXU—Thompson Reuters)
- S&P 10-Year Note Futures TR (SPUSTTTR—Bloomberg)
- US Effective Fed Funds Rate (DFF) (FEDL01—Bloomberg)

What is the Elite Tier Stock Screen?

The growth "engine" of the Franklin Factors US Index is a smart beta US equity index developed by Franklin Systematic™. The index features The Elite Tier Stock Screen that starts with a list of 1,000 well-recognized US stocks and assigns a score to each based on a combination of three key factors: Quality, Value, and Momentum. Our research has determined that these factors can be the most reliable indicators of a stock's future performance. Once each stock has been scored, the index ranks them and focuses on only those in the top 250. These rankings are rebalanced quarterly, generally occurring at quarter-end periods.

What is the anticipated average exposure to equity?

While the index rebalances its asset class exposures daily, the backtests over 20 years[1] show that the average allocation to equity was just over 31% and at maximum did not exceed 81%. Forward-looking equity exposure is dependent on market volatility and will vary.

How does "Dynamic Shift Technology" work?

Dynamic Shift Technology has three main components that work in harmony on a day-to-day basis with the objective of meeting the 5% volatility target:

1. **A daily allocation rule to determine the split between equity and fixed income.** If recent equity volatility is greater than 5%, the index uses a systematic rule to determine an increase in fixed income allocation. Similarly, if recent volatility is less than 5%, the mathematical formula determines a decrease in fixed income allocation.

2. **A short-term allocation to cash.** If the short-term volatility of the index is still greater than 5%, the index uses a systematic rule to reduce the allocation to both equity and fixed income in order to increase the allocation to cash.

3. **A short-term leverage into equity.** If the short-term volatility of the index is still below 5%, the index uses a systematic rule to simulate an increase in leverage in order to increase the amount allocated to equity and fixed income.

1. As of March 31, 2022.

What was the historical max drawdown for the index?

In the historical backtests, the max drawdown was -8.07% (January 24, 2018 to June 19, 2019).[1]

How often is cash used to reduce volatility?

How frequently the index will allocate to cash will depend on market volatility, but in historical backtests over the past 20 years,[1] volatility was greater than or equal to 5% on about 58% of days, during which the index allocated a portion of assets to cash in order to reduce volatility. The highest historical allocation to cash occurred in March 2009, when cash reached above 60% for 9 consecutive days. The second highest historical allocation to cash occurred in October 2008, when the portfolio's cash allocation reached above 60% for 6 consecutive days.[1]

How often is leverage used to boost volatility?

In the historical backtests over the past 20 years,[1] volatility was lower than 5% on about 42% of days. On these days, the index simulated an increase in leverage to increase exposure to equity and/or fixed income in order to increase the volatility to 5%.

Under what conditions might the index perform differently than the broader market?

The amount of equity exposure that the Franklin Factors US Index can take on is dictated by a systematic formula balancing estimates of equity risk with fixed income risk. Generally speaking, because equity is more volatile than fixed income, the index has lower equity exposure in periods where market volatility is high. Conversely, in periods where equity market volatility is low, the index can take on greater equity exposure.

- During periods of rapid decline and high equity market volatility—such as those experienced in 2001, 2002 and 2008—the index exposure to equity was systematically reduced. In these conditions, the Franklin Factors US Index outperformed the S&P 500.

- During periods of a broad market rally accompanied by high volatility—such as the 2009 recovery—the index would have reduced its exposure to equity in order to maintain its 5% volatility profile. In conditions such as this, the index underperformed the S&P 500.

	Total Return (Hypothetical Prior to September 4, 2020)		Average Weight (Exposure)	
	Franklin Factors US Index	S&P 500 PR Index	Equity	Fixed Income
2001	-3.70	-13.04	23.70%	62.13%
2002	6.20	-23.37	24.71%	69.24%
2003	9.60	26.38	29.39%	65.79%
2004	8.40	8.99	34.16%	45.85%
2005	3.19	3.00	34.79%	52.35%
2006	2.00	13.62	34.20%	52.35%
2007	5.97	3.53	35.69%	66.94%
2008	1.94	-38.49	16.89%	61.19%
2009	2.28	23.45	14.37%	53.53%
2010	13.04	12.78	28.24%	75.53%
2011	9.65	0.00	29.82%	74.47%
2012	7.15	13.41	42.13%	76.79%
2013	8.99	29.60	38.55%	56.44%
2014	6.58	11.39	44.75%	62.51%
2015	-1.72	-0.73	34.60%	63.77%
2016	3.00	9.54	40.15%	63.93%
2017	12.89	19.42	63.42%	41.91%
2018	-1.96	-6.24	36.41%	68.38%
2019	9.33	28.88	38.08%	70.34%
2020	5.87	16.26	23.44%	72.01%
2021	3.87	26.89	31.21%	58.41%

Sources: Bloomberg, S&P, Morningstar Direct. The Franklin Factors US Index is an excess return index. The index levels represent performance in excess of the US Effective Fed Funds Rate. **Performance data quoted represents past performance, which does not guarantee future results. Current performance may differ from figures shown.** All information for the index prior to its launch date is backtested and based on the methodology that was in effect on the launch date on September 4, 2020. Backtested performance, which is hypothetical is subject to inherent limitations because it reflects application of an index methodology and selection of index constituents in hindsight. No theoretical approach can take into account all of the factors in the markets in general and the impact of decisions that might have been made during the actual operation of an index. Actual returns may differ from and be lower than backtested returns. The performance data does not reflect the deduction of any fees/charges and assumes reinvestment of interest or dividends. There can be no assurance that implementation of managed volatility strategies will produce desired results.

1. As of March 31, 2022.

How often does the index rebalance?

Unlike market-cap weighted indexes which need to rebalance periodically to account for changes in market cap, the Franklin Factors US Index employs a systematic approach that rebalances daily to blend the asset mix in order to maintain the 5% volatility target.

Who is administering the index?

Franklin Factors US Index is administered by Standard & Poor's.

https://www.spglobal.com/spdji/en/custom-indices/franklin-templeton/franklin-factors-us-index/#overview

What are the key features of the Franklin Factors US Index?

1. **The Elite Tier Stock Screen** seeks to screen for the highest quality US stocks, providing an engine for growth.
2. **Dynamic Shift Technology** aims to manage the fluctuation in capital during periods of market volatility.
3. By **systematically managing volatility** in an effort to limit drawdowns, the time-to-recovery may be shortened.

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For more information about the Franklin Factors US Index:

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www.franklinfactorsusindex.com

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The Index is an excess return index. The Index levels represent performance in excess of the US Effective Fed Funds Rate.

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WHAT ARE THE RISKS?

Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. Bond prices generally move in the opposite direction of interest rates. Thus, as the prices of bonds adjust to a rise in interest rates, the performance of the Index may decline. During times of extreme market volatility, the Index will not be able to eliminate market losses or capture all market gains.