FRANKLIN TEMPLETON INVESTMENTS

Franklin Small Cap Growth SMA

Second Quarter 2015

Market Commentary

MARKET REVIEW

Although signs of US economic reacceleration multiplied this spring following an anemic start to the year, broad US equity market indexes ended the second quarter of 2015 on a somewhat muted note amid heightened volatility. Major stock market gauges pulled back from highs reached in May as Greece's debt crisis deepened and investor sentiment about divergent monetary policies across the globe shifted. Lackluster US profits aligned with the country's first-quarter economic contraction produced the lowest level of year-over-year corporate earnings growth in 11 quarters, further weighing on sentiment. However, US equity markets were supported by an economy that appeared to strengthen, with robust job gains and an unemployment level that dropped to a new recovery low; rising home, retail and vehicle sales; expansion in the factory and services sectors; and a surge in measures of consumer confidence. Other key drivers included a rebound in business capital spending and multi-year highs for global merger-and-acquisition activity. Relative strength in the US dollar, though waning by period-end as investors began to brace for higher US interest rates, was a notable headwind to US export demand, factory activity and the overseas earnings of US multinational corporations.

Performances among the 10 major US equity sectors were split, with health care, consumer discretionary and financials faring best over the quarter, while utilities, industrials and energy had the steepest declines. Small-capitalization stocks posted modest gains that outpaced those in the large-cap tier, while mid-cap stocks declined. By investment style, growth equities performed better than their value-oriented counterparts regardless of company size. Across the world's developed equity markets, the United States lagged the advance of markets across much of Europe and Asia. Most emerging markets also topped US equities, both of which edged out the nearly flat combined return for global frontier markets.

INVESTMENT STRATEGY

For second-quarter 2015, the Franklin Small Cap Growth SMA strategy outperformed the Russell 2000® Index, the Russell 2000® Growth Index and the Russell 2000® Value Index, which returned 0.42%, 1.98% and -1.20%, respectively. Stock selection, particularly in the consumer discretionary sector, buoyed relative returns. Conversely, the information technology and health care sectors were the main detractors from relative performance.

Strong first-quarter financial results boosted shares of our holdings in an entertainment technology company, an online education solutions provider and a fast-casual restaurant chain. In contrast, an automotive supplier detracted from the strategy's quarterly returns.

Although the gradual rise in oil prices benefited many of our positions in the energy sector, a Gulf Coast independent exploration and production company reported a net loss in the first quarter and declined in value.

The industrials sector also contributed to relative performance, especially many of our holdings in the commercial and professional services industry, though it was hampered by declining shares of an aerospace and defense Industry Company.

The information technology sector was pressured by several semiconductor companies, a three-dimensional imaging company and a mobile information technology platform provider. Conversely, shares of an e-commerce platform soared on news of its acquisition in early May and benefited returns. A position in a cloud-based digital commerce solutions provider also added to quarterly results.

Health care sector holdings that detracted from returns included two medical devices companies and a life sciences tools company. However, the health care sector included several of the strategy's leading contributors for the quarter, notably an emergency room operator, a medical devices company, a cosmetic pharmaceutical developer and two biotechnology companies.

OUTLOOK

Looking toward the remainder of 2015, we expect that the US economy will continue to expand at a modest pace and that the US equity markets should retain solid performance potential, particularly as uncertainty regarding the Federal Reserve's first interest-rate increase is removed. US economic data has been encouraging for growth, as suggested by strong employment numbers, rising retail sales and a robust M&A environment, among other indicators. As we look ahead, we continue to see the two main pillars of the US economy—consumer spending and corporate earnings—supported by a modest economic growth environment.

Consumer confidence continues to reflect a positive outlook and is currently above levels we saw in 2007. The low inflation, low interest-rate environment, combined with steadily improving prospects for jobs and incomes, has bolstered consumer optimism. We believe the improving job market, rising personal income and upbeat economic sentiment will benefit consumer spending going forward.

US consumers also have more money in their pockets because, in general, they have aggressively shed their personal debts and increased their savings rate since the financial crisis. We see this as a fundamental, although often overlooked, driver of consumer spending strength in the years ahead.

Meanwhile, many US companies have also cleaned up their debts and generated strong earnings in recent years. The result is that US companies have stockpiled record levels of cash on their balance sheets. Areas where corporations have put this cash to work include continued dividend increases and share buybacks; ongoing investment and capital expenditures as well as research and development; and increased productivity and lower cost structures. We think the most meaningful effect of extra corporate cash, however, has been the M&A activity that has accelerated over the last two years. We believe that trend will continue going forward as US companies continue to acquire strategic assets to enable them to enter new growth markets or consolidate fragmented industries.

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Franklin Small Cap Growth SMA Composite consists of all fully discretionary accounts with a small cap growth investment objective and for which the brokerage (including trading expenses), administrative, custodial, and investment management fees are charged together as a percentage of the portfolios' assets ("wrap fee"). All accounts in the composite have a wrap fee (also known as a bundled or "comprehensive" fee) for all time periods presented. Smaller-company stocks have historically exhibited greater price volatility than larger-company stocks, particularly over the short-term. Between June 30, 2012 and December 31, 2012, the composite name was Franklin Small Cap Growth SMA Wrap Fee Composite. Prior to June 30, 2012, the composite name was Franklin Portfolio Advisors Small Cap Growth Composite - Wrap Fee. Effective April 2, 2012, Franklin Advisers, Inc., assumed responsibility for Franklin Separately Managed Accounts' small cap strategy accounts, including those in the Franklin Small Cap Growth SMA Composite. Franklin Advisers, Inc. is a sub adviser to Franklin Separately Managed Accounts.

The primary benchmark for this composite is the Russell 2000® Growth Index, which is a float-adjusted market capitalization weighted equity index comprised of securities of small-cap U.S. companies with high price-to-book ratios and high forecasted growth values. The Russell 2000® Growth Index is an unmanaged index representing the investment environment existing during the time periods shown. It is presented for comparison purposes only and cannot accommodate direct investment.

Additional information regarding the firm's policies and procedures for calculating and reporting performance results in available upon request. To receive a complete list of composite descriptions and/or a presentation that adheres to the GIPS® standards for any composite, please contact your Franklin Templeton representative at (800) 822-8464 or visit www.franklintempleton.com.

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