

Franklin Biotechnology Discovery Fund

Advisor Class: FTDZX Class A: FBDIX

Commentary | as of June 30, 2025

Key Takeaways

- **Markets:** Global equities collectively rose during 2025's second quarter (2Q25) after bouncing back from their April lows. As measured by the MSCI All Country World Index in US-dollar terms, nine out of the 11 global equity sectors advanced; information technology (IT), communication services and industrials produced the highest returns, while energy and health care retreated. In terms of investment style, global growth stocks significantly outperformed their value-oriented counterparts, regardless of company size. With health care stocks largely absent from the 2Q25 global uptrend, four out of six related industries sold off, with the steepest declines occurring in health care providers and services, life sciences tools and services, and biotechnology. Health care technology was an outlier to the upside, along with the health care equipment and supplies industry. Overall weakness in biotech was driven by a combination of US-specific policy uncertainties, rising operational costs, and financial pressures from Medicaid redeterminations. Biotech stocks, particularly smaller firms reliant on global supply chains for research and manufacturing, were impacted by the specter of increased costs and disrupted trade flows. The uncertainty around tariff policies raised concerns about higher costs for raw materials, equipment, and clinical trial supplies, which disproportionately affect capital-intensive biotech firms. Some investors likely moved away from health care due to these headwinds, along with the sector's defensive nature and slow-growth outlook, which were less appealing in a bullish market environment.
- **Contributors:** Stock selection in the biotechnology industry and beneficial overweighting in health care services.
- **Detractors:** Stock selection and an underweighting in the life sciences tools and services industry and, to a lesser extent, stock selection in pharmaceuticals.
- **Outlook:** We believe the biotechnology industry is poised for long-term growth due to its competitive advantages, innovation, and increasing pharmaceutical expenditures driven by aging populations. Advances in artificial intelligence (AI) and novel therapies are expanding market opportunities, despite risks related to inflation, regulatory and reimbursement challenges (i.e., drug pricing reforms).

Performance Review

- Within the biotech industry, the fund's slightly-negative return compared well with the index's larger overall losses, thanks to several overweighted or off-index contributors that rallied with double-digit percentage gains, led by Merus, Insmmed, ARS Pharmaceuticals, Ascendis Pharma, UniQure, CytomX Therapeutics (purchased during the period) and Akebia Therapeutics. We also maintained lighter-than-index exposures to poor performers such as Regeneron Pharmaceuticals and avoided numerous index component companies that sustained significant losses.
- Among the key contributors cited above, CytomX, a clinical-stage oncology treatment developer, was a substantial outlier to the upside. CytomX announced a significant milestone with promising interim results from its ongoing Phase 1 dose-escalation study of CX-2051, an antibody-drug conjugate targeting EpCAMs (epithelial cell adhesion molecules) playing a crucial role in advanced colorectal cancer. CytomX continues to collaborate with major players like Bristol-Myers Squibb (not held by the fund), fund holding Amgen and Moderna (not held) to advance its oncology pipeline.
- Overall, the biotech industry experienced several positive developments that provided some counterbalance to the broader health care sector's ongoing 2025 challenges. Upside drivers included promising drug approvals and clinical progress (including gene therapies), a few announced strategic partnerships and investments, and signs of increased optimism about biotech IPOs (initial public offerings). Elsewhere in the portfolio, our high return in the health care services industry was due to a solitary overweight position in Guardant Health that rallied solidly. The fund's overall losses in the pharmaceuticals industry were partially mitigated by huge rallies for key contributor EyePoint Pharmaceuticals and a few others.
- Conversely, the fund sustained a modest loss in the pharmaceuticals industry as off-benchmark or overweight positions in Jazz Pharmaceuticals, Contineum Therapeutics and Eli Lilly fell much further than the benchmark average.
- In the biotech industry, absolute and relative returns were hindered by declines for the fund's overweighted or off-benchmark investments in Benitec Biopharma, Mineralys Therapeutics, Arcutis Biotherapeutics, Syndax Pharmaceuticals, Zealand Pharma, Day One Biopharmaceuticals and others that sustained 2Q25 losses of more than 10%. Relative returns were further pressured by an underweighting in Alnylam Pharmaceuticals as its share price jumped nearly 21%, and by the portfolio's lack of exposure to Blueprint Medicines, Exelixis and other index component companies that rallied.
- A minor portfolio allocation in the life sciences tools and services industry traded lower, with results versus the index hindered by a lack of exposure to Illumina and Tempus AI.

Outlook

- The portfolio continues to emphasize mid-, small- and micro-capitalization biotech stocks, tilted toward what we believe to be clinically or commercially "derisked" assets.
- Our positive outlook is based on what we consider to be generally strong fundamentals and appealing valuations backed partly by innovation in new drug modalities, a potentially strong merger-and-acquisition (M&A) cycle returning later this year (after sticking points related to tariffs and Most Favored Nation [MFN] pricing policies are resolved), and relatively stable Medicare drug reimbursement. As it pertains to M&A, we are still waiting to see implementation details in terms of how the Trump administration works through looming tariff and MFN pricing policy actions. We view these as important "clearing events" that can help ease investor uncertainty and potentially open up biotech M&A activity once they're clarified.
- Conversely, we remain cognizant of risks to biopharma innovation and stock performance linked to the persistence of inflation and the potential for only minimal interest-rate reductions in the United States in the latter half of 2025. Recent developments related to US Food & Drug Administration staffing and global tariffs add to near-term uncertainty.

Top Equity Issuers (% of Total)

Holding	Fund
GILEAD SCIENCES INC	7.86
VERTEX PHARMACEUTICALS INC	6.85
AMGEN INC	6.58
ASCENDIS PHARMA A/S	5.16
REGENERON PHARMACEUTICALS INC	4.63
INSMED INC	4.16
ARGENX SE	3.91
JAZZ PHARMACEUTICALS PLC	3.70
MERUS NV	3.29
PTC THERAPEUTICS INC	3.17

Sector Allocation (% of Total)

Industry	Fund
Biotechnology	83.72
Pharmaceuticals	11.19
Health Care Services	2.48
Life Sciences Tools & Services	1.97
Managed Health Care	0.19
Cash & Cash Equivalents	0.46

Average annual total returns and fund expenses (%) - as of June 30, 2025

Class	CUSIP	Ticker	Without Sales Charge							With Maximum Sales Charge							Expenses		Sales Charges		Inception Date
			3-Mo	YTD	1-Yr	3-Yr	5-Yr	10-Yr	Inception	3-Mo	YTD	1-Yr	3-Yr	5-Yr	10-Yr	Inception	Gross	Net	Initial Charge	CDSC	
Advisor Class	354713398	FTDZX	-0.07	-4.58	-9.15	8.89	-0.37	1.03	9.35	-0.07	-4.58	-9.15	8.89	-0.37	1.03	9.35	0.81	0.80	—	—	9/15/1997
Class A	354713844	FBDIX	-0.13	-4.69	-9.38	8.62	-0.61	0.78	9.19	-5.62	-9.94	-14.36	6.59	-1.73	0.21	8.97	1.06	1.05	5.50	—	9/15/1997
Benchmark 1	—	—	-0.39	-1.92	-6.99	4.09	-0.33	0.90	—	-0.39	-1.92	-6.99	4.09	-0.33	0.90	—	—	—	—	—	—
Benchmark 2	—	—	10.94	6.20	15.16	19.70	16.64	13.64	—	10.94	6.20	15.16	19.70	16.64	13.64	—	—	—	—	—	—

Benchmark(s)

Benchmark 1=NASDAQ Biotechnology Index

Benchmark 2=S&P 500 Index

Performance data quoted represents past performance, which does not guarantee future results. Current performance may be lower or higher than the figures shown. Principal value and investment returns will fluctuate, and investors' shares, when redeemed, may be worth more or less than the original cost. Performance would have been lower if fees had not been waived in various periods. Total returns assume the reinvestment of all distributions and the deduction of all fund expenses. Returns with sales charge reflect a deduction of the stated maximum sales charge. An investor cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges. Returns for periods of less than one year are not annualized. All classes of shares may not be available to all investors or through all distribution channels. For current month-end performance, please visit franklintempleton.com. The fund began offering Advisor Class shares on 9/1/2009. Performance quotations have been calculated as follows: (a) for Advisor Class periods prior to 9/1/2009, a restated figure is used based on the fund's Class A performance. The performance was adjusted to take into account differences in class-specific operating expenses and maximum sales charges. (b) For periods after share class offering, performance for the specific share class is used, reflecting the expenses and maximum sales charges applicable to that class. Gross expenses are the fund's total annual operating expenses as of the fund's prospectus available at the time of publication. Actual expenses may be higher and may impact portfolio returns. Net expenses reflect contractual fee waivers, expense caps and/or reimbursements, which cannot be terminated prior to 08/31/2025 without Board consent. Additional amounts may be voluntarily waived and/or reimbursed and may be modified or discontinued at any time without notice.

What are the Risks?

All investments involve risks, including possible loss of principal. 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. To the extent the portfolio invests in a **concentration of certain securities, regions or industries**, it is subject to increased volatility. **Small- and mid-cap stocks** involve greater risks and volatility than large-cap stocks. **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**. The manager may consider **environmental, social and governance (ESG) criteria** in the research or investment process; however, ESG considerations may not be a determinative factor in security selection. In addition, the manager may not assess every investment for ESG criteria, and not every ESG factor may be identified or evaluated. These and other risks are discussed in the fund's prospectus.

Glossary

An **initial public offering (IPO)** is the process of offering shares in a private corporation to the public for the first time. The **MSCI All Country World Index** is a market capitalization-weighted index that is designed to measure equity market performance of developed and emerging markets. Source: MSCI makes no warranties and shall have no liability with respect to any MSCI data reproduced herein. No further redistribution or use is permitted. This report is not prepared or endorsed by MSCI.

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. The **NASDAQ Biotechnology Index** is a modified capitalization-weighted index designed to measure performance of all NASDAQ stocks in the biotechnology sector. Source: Nasdaq OMX. The **S&P 500 Index** features 500 leading U.S. publicly traded companies, with a primary emphasis on market capitalization. Source: © S&P Dow Jones Indices LLC. All rights reserved. Important data provider notices and terms available at www.franklintempletondatasources.com. All data is subject to change. Franklin Distributors, LLC. Member FINRA/SIPC. © Franklin Templeton. All rights reserved.

Before investing, carefully consider a fund's investment objectives, risks, charges and expenses. You can find this and other information in each prospectus, or summary prospectus, if available, at www.franklintempleton.com. Please read it carefully.