

Product Profile

Product Details¹

Fund Assets	\$61,920,852.64
Fund Inception Date	02/01/1993
Number of Holdings	356
Investment Style	Investment Grade
Benchmark	Bloomberg Barclays US MBS Agency Fixed Rate MBS Index
Lipper Classification	U.S. Mortgage Funds
Morningstar Category™	Intermediate-Term Bond
Dividend Frequency	Accrued daily and paid monthly on the last business day

	CUSIP	NASDAQ Symbol
Advisor Class	354 71H 405	FSMZ

Maximum Sales Charges

Advisor Class	None
---------------	------

Total Annual Operating Expenses With Waiver Without Waiver

Advisor Class	0.76%	0.96%
---------------	-------	-------

30-Day Standardized Yield² With Waiver Without Waiver

Advisor Class	3.88%	3.56%
---------------	-------	-------

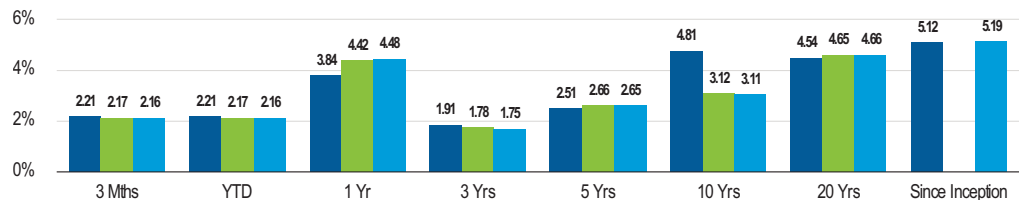
Fund Description

The fund seeks to provide high total return (a combination of high current income and capital appreciation) relative to the performance of the general mortgage securities market. The fund invests substantially in mortgage securities that are issued or guaranteed by the U.S. government, its agencies or instrumentalities, including securities issued by Ginnie Mae and government-sponsored entities such as Fannie Mae and Freddie Mac.³ The fund also invests in other types of residential and commercial mortgage securities, including securities that are not issued or guaranteed by the U.S. government, its agencies or instrumentalities.

Performance Data^{4,5}

Average Annual Total Returns⁶ (%)

	3 Mths	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs	20 Yrs	Since Inception (02/01/1993)
Advisor Class	2.21	2.21	3.84	1.91	2.51	4.81	4.54	5.12
Bloomberg Barclays US MBS Agency Fixed Rate MBS Index	2.17	2.17	4.42	1.78	2.66	3.12	4.65	-
FTSE U.S. Broad Investment-Grade Mortgage Index	2.16	2.16	4.48	1.75	2.65	3.11	4.66	5.19



■ Advisor Class
■ Bloomberg Barclays US MBS Agency Fixed Rate MBS Index
■ FTSE U.S. Broad Investment-Grade Mortgage Index

Performance data represents past performance, which does not guarantee future results. Current performance may differ from figures shown. The fund's investment return and principal value will change with market conditions, and you may have a gain or a loss when you sell your shares. Please call Franklin Templeton Investments at (800) DIAL BEN/342-5236 or visit franklintempleton.com for the most recent month-end performance.

Advisor Class shares are offered only to certain eligible investors as stated in the prospectus. They are offered without sales charges or Rule 12b-1 fees. The fund offers other share classes subject to different fees and expenses, which will affect their performance. Please see the prospectus for details.

The fund has an expense reduction and a fee waiver associated with any investments it makes in a Franklin Templeton money fund and/or other Franklin Templeton fund, contractually guaranteed through 01/31/2020. Fund investment results reflect the expense reduction and fee waiver; without these reductions, the results would have been lower.

1. All holdings are subject to change.

2. The fund's 30-day standardized yield is calculated over a trailing 30-day period using the yield to maturity on bonds and/or the dividends accrued on stocks. It may not equal the fund's actual income distribution rate, which reflects the fund's past dividends paid to shareholders.

5. Source for Index: FactSet. Indexes are unmanaged, and one cannot invest directly in an index. They do not reflect any fees, expenses or sales charges.

6. Periods shorter than one year are shown as cumulative total returns.

Calendar Year Returns (%)

	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009
Advisor Class	0.36	2.92	1.78	0.99	6.70	0.67	6.05	6.85	11.39	10.54
Bloomberg Barclays US MBS Agency Fixed Rate MBS Index	0.99	2.48	1.67	1.51	6.15	-1.45	2.60	6.32	5.50	5.75
FTSE U.S. Broad Investment-Grade Mortgage Index	1.01	2.47	1.59	1.56	6.12	-1.52	2.60	6.38	5.50	5.75

Performance data represents past performance, which does not guarantee future results. Current performance may differ from figures shown. The fund's investment return and principal value will change with market conditions, and you may have a gain or a loss when you sell your shares. Please call Franklin Templeton Investments at (800) DIAL BEN/342-5236 or visit franklintempleton.com for the most recent month-end performance.

Portfolio Manager Insight⁷

Performance Review

QUARTERLY KEY PERFORMANCE DRIVERS

	Sector Exposure	Duration/Yield Curve
HELPED	Overweight allocation to non-agency residential mortgage-backed securities (RMBS)	US yield-curve positioning
	Security selection in agency mortgage-backed securities (MBS)	—
	Overweight allocation to CMBS	—
HURT	Underweight allocation to agency MBS	—
	Security selection in commercial mortgage-backed securities (CMBS)	—
	—	—

- In terms of our sector allocation, we maintained our largest allocation in agency mortgage-backed securities, but continued to hold an underweight position versus the benchmark in the sector as we believe there are better opportunities in the non-agency sectors.
- We increased exposure to RMBS which contributed to relative performance against the backdrop of a credit market recovery during Q1. For our RMBS exposure we prefer to remain allocated to the seasoned Credit Risk Transfer and Re-performing Loan sectors, where both fundamental and technical forces remain positive. As we have decreased our CMBS allocation, we maintained our exposure at the top of the capital structure as slowing rent growth and the rise in commercial real estate values over the past few years might be difficult to sustain in the latter stages of an expansionary business cycle, in our view.
- Our yield curve positioning contributed to relative results during Q1.

Outlook & Strategy

- The underpinnings of the US economy's expansion appear solid, in our view, particularly once the length of the current economic cycle is considered. The strength of the labor market should provide a cushion for US consumers, with slow-but-steady wage growth likely to further bolster spending. Though some recent data have come in below consensus expectations, the misses may have been exaggerated by seasonal factors, which have often skewed calculations around this time of the year.
- Given the economy's residual strength and these potential statistical anomalies, we would expect any first-quarter 2019 weakness to prove temporary, and a stabilization of growth over the rest of the year looks like a far more plausible scenario than a slide into recession. Political risks remain, however, especially surrounding the terms of trade between the United States and China. Nevertheless, in the absence of any major geopolitical shocks, we anticipate the Fed could resume its monetary tightening path in the latter part of 2019.

7. 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.

Portfolio Characteristics^{8,9,10,11}

	Portfolio	Bloomberg Barclays US MBS Agency Fixed Rate MBS Index
Average Duration	4.11 Yrs	4.03 Yrs
Average Weighted Maturity	5.36 Yrs	6.11 Yrs

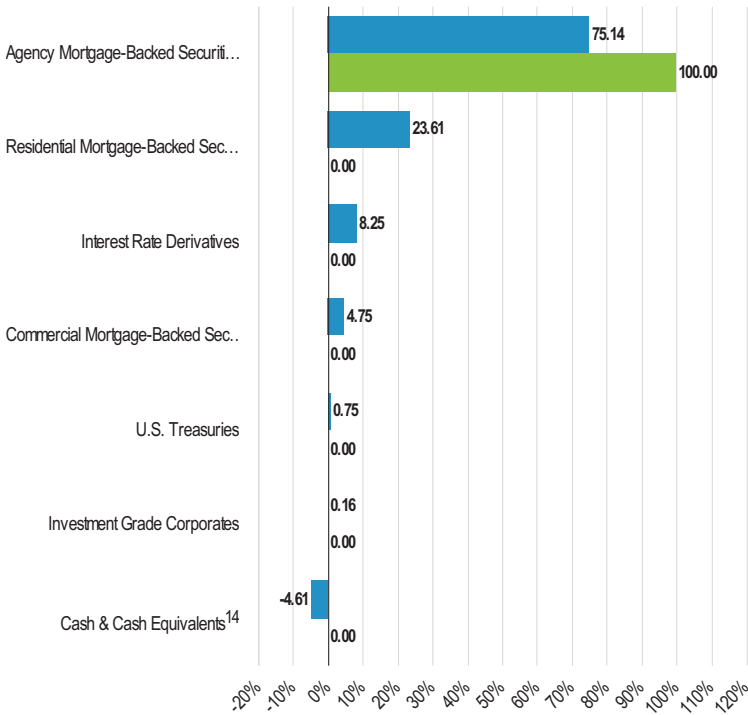
8. The portfolio characteristics listed are based on the fund's underlying holdings, and do not necessarily reflect the fund's characteristics. Information is historical and may not reflect current or future portfolio characteristics. All holdings are subject to change.

9. Source for Index: FactSet. Indexes are unmanaged, and one cannot invest directly in an index. They do not reflect any fees, expenses or sales charges.

Portfolio Diversification¹¹

Sector Exposure vs. Bloomberg Barclays US MBS Agency Fixed Rate MBS Index^{12,13}

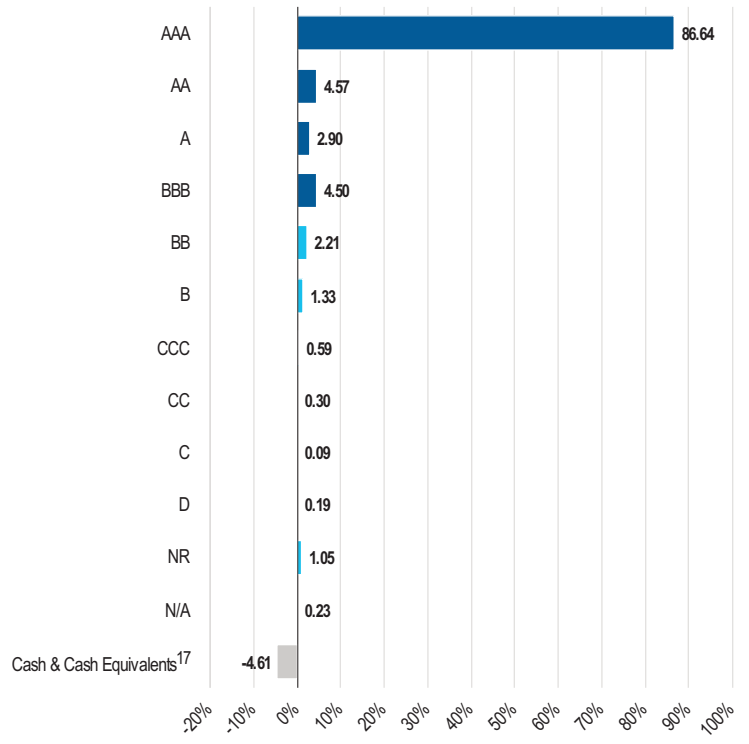
Notional Exposure—Percent of Total



■ Franklin Strategic Mortgage Portfolio
 ■ Bloomberg Barclays US MBS Agency Fixed Rate MBS Index

Credit Quality Allocation^{15,16}

Market Value—Percent of Total



■ Investment Grade ■ Non-Investment Grade ■ Cash & Cash Equivalents

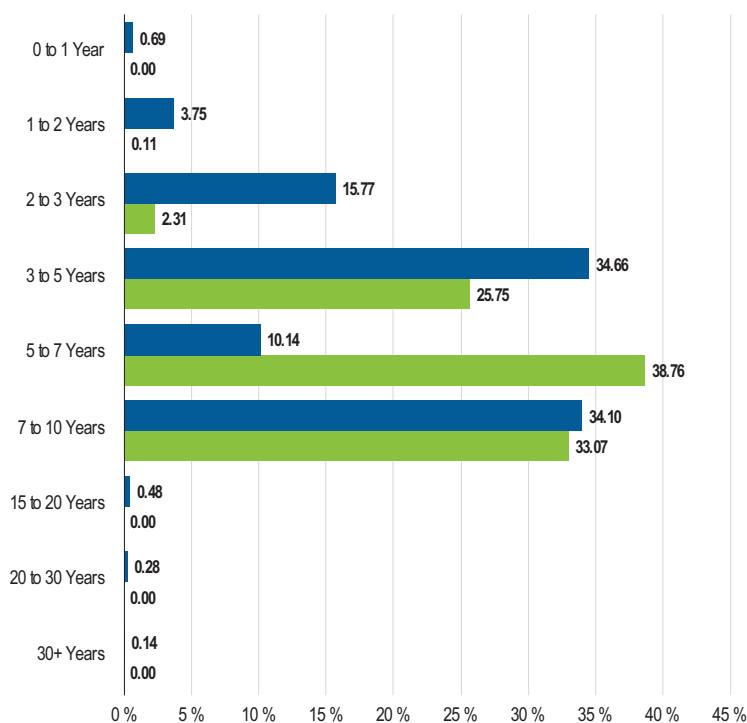
13. Source for Index: FactSet. Indexes are unmanaged, and one cannot invest directly in an index. They do not reflect any fees, expenses or sales charges.

14,17. The negative cash position reflects a temporary position that is a result of a delay in securities settlement transactions.

16. Ratings shown are assigned by one or more Nationally Recognized Statistical Rating Organizations ('NRSRO'), such as Standard & Poor's, Moody's and Fitch. The ratings are an indication of an issuer's creditworthiness and typically range from AAA or Aaa (highest) to D (lowest). When ratings from all three agencies are available, the middle rating is used; when two are available, the lowest rating is used; and when only one is available, that rating is used. Foreign government bonds without a specific rating are assigned the country rating provided by an NRSRO, if available. The NR category consists of ratable securities that have not been rated by an NRSRO. The N/A category consists of nonratable securities (e.g., equities). Cash includes equivalents, which may be rated.

Maturity Allocation vs. Bloomberg Barclays US MBS Agency Fixed Rate MBS Index^{15,18}

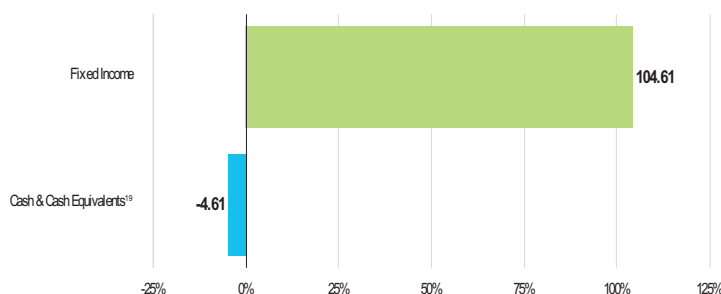
Market Value—Percent of Fixed Income



■ Franklin Strategic Mortgage Portfolio
 ■ Bloomberg Barclays US MBS Agency Fixed Rate MBS Index

Asset Allocation¹⁵

Market Value—Percent of Total



Supplemental Performance Statistics

Supplemental Risk Statistics^{20,21}

	3 Yrs	5 Yrs	10 Yrs
Standard Deviation (%)	2.24	2.06	-
Tracking Error (%)	0.41	0.55	-
Information Ratio	0.35	-0.25	-
Sharpe Ratio	0.32	0.86	-

Performance data represents past performance, which does not guarantee future results. Current performance may differ from figures shown. The fund's investment return and principal value will change with market conditions, and you may have a gain or a loss when you sell your shares. Please call Franklin Templeton Investments at (800) DIAL BEN/342-5236 or visit franklintempleton.com for the most recent month-end performance.

Investment Philosophy

- We seek to identify the most attractive investments across the broad mortgage-related markets, focusing on those we believe are the top investment ideas available within each mortgage-backed-security-related sector (both agency and non-agency).
- The fund invests substantially in mortgage securities that are issued or guaranteed by the U.S. government, its agencies or instrumentalities, including securities issued by government-sponsored entities such as Ginnie Mae, Fannie Mae and Freddie Mac. The fund also invests in other types of residential and commercial mortgage securities, including securities that are not issued or guaranteed by the U.S. government, its agencies or instrumentalities.
- We utilize a large opportunity set of mortgage-backed securities and mortgage-related, asset-backed securities with the aim of broad access to the U.S. mortgage finance market, one of the largest capital markets in the world.

18. Source for Index: FactSet. Indexes are unmanaged, and one cannot invest directly in an index. They do not reflect any fees, expenses or sales charges.

19. The negative cash position reflects a temporary position that is a result of a delay in securities settlement transactions.

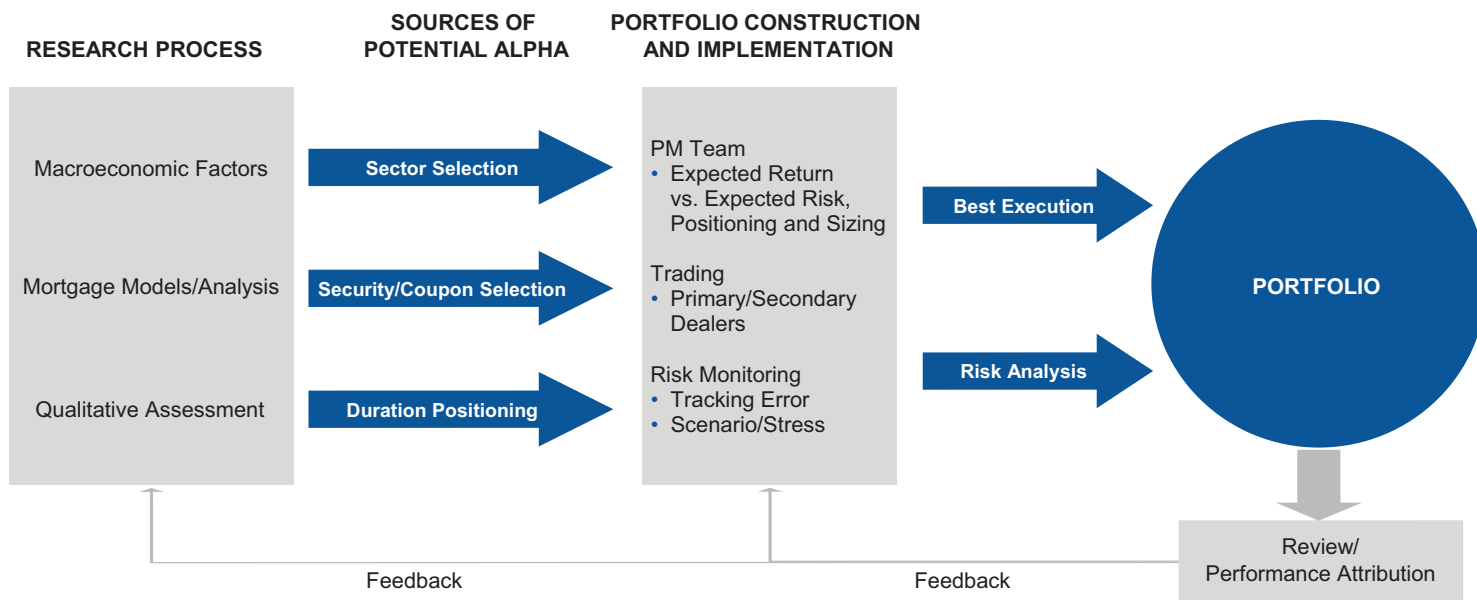
20. Information Ratio and Tracking Error information are displayed for the product versus the Bloomberg Barclays US MBS Agency Fixed Rate MBS Index.

21. Information Ratio is a way to evaluate a manager's ability to outperform a benchmark in relation to the risk that manager is assuming, with risk defined as deviation from the benchmark. This measure is calculated by dividing the portfolio's excess return (portfolio return less the benchmark return) by the tracking error (derived by taking the standard deviation of the monthly differences between the portfolio return and the benchmark return over time).

- We follow a disciplined investment approach designed to explicitly take market conditions into account.

Investment Process

- Our dedicated mortgage portfolio team takes a collateral intensive research approach seeking to uncover opportunities across broad mortgage opportunity sets. We believe our experience and continual investment in new technologies can help us identify specified pools and individual securities that can offer strong cash flow fundamentals and valuations.
- We emphasize a bottom-up, relative value investment approach based on our rigorous proprietary research. Our top-down analysis incorporates the macroeconomic views of the Franklin Templeton Fixed Income Policy Committee (FIPC). The majority of time spent by our research groups and sector specialists is in bottom-up analysis in security selection and to determine sector recommendations.



Investment Team

Portfolio Manager	Years with Firm	Years Experience
Roger Bayston, CFA, SVP / Director, Investment Grade Fixed Income	27	33
Paul Varunok, SVP / Head of Mortgage Portfolio Management	18	27
David Yuen, CFA, SVP/Head of Quantitative Portfolio Management Group	23	31
Additional Resources		
MBS	Quantitative	

Average Duration: A measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years.

Average Weighted Maturity: An estimate of the number of terms to maturity, taking the possibility of early payments into account, for the underlying holdings. Maturity is expressed as a number of years.

Information Ratio: In investing terminology, the ratio of expected return to risk. Usually, this statistical technique is used to measure a manager's performance against a benchmark. This measure explicitly relates the degree by which an investment has beaten the benchmark to the consistency by which the investment has beaten the benchmark.

Sharpe Ratio: To calculate a Sharpe ratio, an asset's excess returns (its return in excess of the return generated by risk-free assets such as Treasury bills) are divided by the asset's standard deviation.

Standard Deviation: A measure of the degree to which returns vary from the average of its previous returns. The larger the standard deviation, the greater the likelihood (and risk) that performance will fluctuate from the average return.

Tracking Error: Measure of the deviation of the return of a product compared to the return of a benchmark over a fixed period of time. Expressed as a percentage. The more passively the investment is managed, the smaller the tracking error.

What Are The Risks?

All investments involve risks, including possible loss of principal. The share price and yield of Franklin Strategic Mortgage Portfolio will be affected by interest rate movements and mortgage prepayments. During periods of declining interest rates, principal prepayments tend to increase as borrowers refinance their mortgages at lower rates; therefore the fund may be forced to reinvest returned principal at lower interest rates, reducing income. Bond prices generally move in the opposite direction of interest rates. Thus, as the prices of bonds in the fund adjust to a rise in interest rates, the fund's share price may decline. The fund may be affected by issuers that fail to make interest payments and repay principal when due. Changes in the financial strength of a bond issuer or in a bond's credit rating may affect its value. The fund is actively managed but there is no guarantee that the manager's investment decisions will produce the desired results. These and other risk considerations are discussed in the fund's prospectus.

Important Legal Information

Investors should carefully consider a fund's investment goals, risks, charges and expenses before investing. To obtain a summary prospectus and/or prospectus, which contains this and other information, talk to your financial advisor, call us at (800) DIAL BEN/342-5236 or visit franklintempleton.com. Please carefully read a prospectus before you invest or send money.

CFA® and Chartered Financial Analyst® are trademarks owned by CFA Institute.

Source: FTSE. Important data provider notices and terms available at www.franklintempletondatasources.com.

3. A portion of the mortgage securities owned by the fund, but not shares of the fund, are guaranteed by the US government, its agencies or instrumentalities as to timely payment of principal and interest. Although Fannie Mae and Freddie Mac are chartered by Acts of Congress, their securities are backed only by the credit of the respective instrumentality and are not issued or guaranteed by the US government. Please see the fund's prospectus for a detailed discussion regarding various levels of credit support for government agency or instrumentality securities. The fund's yield and share price are not guaranteed and will fluctuate with market conditions.

4. Effective 02/01/2012, the fund began offering Advisor Class Shares. For periods prior to the fund's Advisor Class inception date, a restated figure is used based on the fund's oldest share class, Class A performance, excluding the effect of Class A's maximum initial sales charge but reflecting the effect of the Class A Rule 12b-1 fees; and b) for periods after the fund's Advisor Class inception date, actual Advisor Class performance is used, reflecting all charges and fees applicable to that class.

10. Average Duration and Average Weighted Maturity reflect certain derivatives held in the portfolio (or their underlying reference assets).

11. Information is historical and may not reflect current or future portfolio characteristics. All holdings are subject to change.

12. Notional exposure figures are intended to estimate the portfolio's exposure, including any hedged or increased exposure through certain derivatives held in the portfolio (or their underlying reference assets). Portfolio breakdown percentages may not total 100% and may be negative due to rounding, use of any derivatives, unsettled trades or other factors.

15. Market value figures reflect the trading value of the investments. Portfolio breakdown percentages may not total 100% and may be negative due to rounding, use of any derivatives, unsettled trades or other factors.



**FRANKLIN
TEMPLETON**

Franklin Templeton Distributors, Inc.

One Franklin Parkway
San Mateo, CA 94403-1906
(800) DIAL BEN/342-5236
franklintempleton.com