Franklin U.S. Government Securities Fund

Advisor Class: FUSAX Class A: FKFSX | **Commentary | as of June 30, 2025**

Key Takeaways

- **Markets:** There were large swings in financial market sentiment across the second quarter of 2025. US Treasury (UST) yield changes were mixed, with shorter- and intermediate-term yields falling, while longer-maturity yields rose.
- **Contributors:** Allocation to Ginnie Mae (GNMA) I 4.5% through 5.5% coupons. Security selection in GNMA II 3.0%, 3.5%, 4.5% and 6.5% coupons.
- **Detractors:** Security selection in GNMA I 4.5% and 5.0% coupons and GNMA II 4.0% coupons. Allocation to GNMA II 5.0% and 5.5% coupons.
- **Outlook:** In our view, the US Federal Reserve (Fed) is unlikely to cut interest rates soon. Despite recent signs of cooling inflation, Fed officials remain cautious due to ongoing tariff-related uncertainties. We expect longer-term rates to continue to climb higher through the rest of the year.

Fund Characteristics	Fund
Distribution Frequency	Monthly
Effective Duration	5.81 Years
30-Day SEC Yield (Advisor Class)—With Waiver	3.19%
30-Day SEC Yield (Advisor Class)—Without Waiver	3.19%

Performance Review

- The fund's overweight allocation to GNMA I 4.5% through 5.5% coupons contributed to relative performance. Security selection in GNMA II 3.0%, 3.5%, 4.5% and 6.5% coupons benefited results.
- Security selection in GNMA I 4.5% and 5.0% coupons and GNMA II 4.0% coupons detracted from performance.
- The fund's underweight allocation to GNMA II 5.0% and 5.5% coupons hindered results.

Outlook

- Over the quarter, agency mortgage-backed securities (MBS) posted a positive total return and outperformed similar-duration USTs. Conventional MBS, as represented by Fannie Mae, was the best relative performer, followed by GNMA MBS. Across the GNMA coupon stack, 4.5% and 5.0% coupons were the best performers, while 3.5% coupons produced negative excess returns.
- At period-end, we remained heavily weighted to GNMA II securities (comprised of multiple-issuer pools), with over 86.5% of assets in the sector, versus GNMA I securities (comprised of single-issuer pools). The fund's largest absolute allocation remains in GNMA II 2.5% through 3.5% coupons.
- For the MBS sector, prepayment risk remains minimal, mortgage credit quality remains high and sector negative convexity risk remains low. Fundamental and technical outlooks for the sector remain favorable, with strong relative value to investment-grade (IG) corporates. IG corporate spreads relative to MBS option-adjusted spreads are still near historical tights. Although the historically high money manager overweight positioning is a potential hurdle for spread tightening, we anticipate increased demand from banks. Bank demand could increase if the yield curve normalizes or regulatory uncertainty dissipates.
- In our view, the Fed is unlikely to cut interest rates soon. Despite recent signs of cooling inflation, Fed officials remain cautious due to ongoing tariff-related uncertainties. Companies are expected to raise prices as pre-tariff inventories diminish, leading to a likely rise in core goods inflation. Furthermore, average US tariff rates remain historically high despite a temporary easing in US-China trade tensions. We therefore expect potentially higher inflation and slower growth. With inflation still above target and risks skewed to the upside, we expect the Fed to maintain its pause. Amid still resilient industrial production and retail sales, we believe the Fed is likely to stay on hold until there is clear evidence of labor market deterioration without a simultaneous rise in inflation. The "One Big Beautiful Bill" spending package will further increase the US deficit over the next decade. Combined with factors such as uncertain trade policy (which has raised stagflationary concerns) and an expansionary fiscal policy (which implies greater debt issuance), we expect longer-term rates to continue to climb higher through the rest of the year.

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

			Without Sales Charge							With Maximum Sales Charge							Expenses		Sales Charges		Inception
Class	CUSIP	Ticker	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	Date
Advisor Class	353496821	FUSAX	0.90	3.64	5.28	1.77	-0.76	0.76	5.44	0.90	3.64	5.28	1.77	-0.76	0.76	5.44	0.61	0.60	—	—	5/31/1970
Class A	353496482	FKFSX	0.84	3.53	5.04	1.52	-1.01	0.55	5.33	-2.94	-0.36	1.10	0.23	-1.76	0.17	5.26	0.86	0.85	3.75	—	5/31/1970
Benchmark	—	—	1.45	3.97	6.26	2.85	0.15	1.55	—	1.45	3.97	6.26	2.85	0.15	1.55	—	—	—	—	—	—

Benchmark(s)

Benchmark =Bloomberg US Government - Intermediate 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 12/31/1996 and the fund began offering A Class shares on 9/10/2018. Performance quotations have been calculated as follows: (a) for Advisor Class periods prior to 12/31/1996, a restated figure is used based on the fund's Class A1 performance; for A Class periods prior to 9/10/2018, a restated figure is used based on the fund's Class A1 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 01/31/2026 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. Fixed income securities involve interest rate, credit, inflation and reinvestment risks, and possible loss of principal. As interest rates rise, the value of fixed income securities falls. **Asset-backed, mortgage-backed or mortgage-related securities** are subject to prepayment and extension risks. **Changes in the credit rating** of a bond, or in the credit rating or financial strength of a bond's issuer, insurer or guarantor, may affect the bond's value. These and other risks are discussed in the fund's prospectus.

Glossary

Convexity is a measure of the curvature, or the degree of the curve, in the relationship between bond prices and bond yields.

Stagflation is a seemingly contradictory condition described by slow economic growth and relatively high unemployment, or economic stagnation, which is at the same time accompanied by rising prices (i.e. inflation).

The **yield curve** shows the relationship between yields and maturity dates for a similar class of bonds.

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 **Bloomberg U.S. Government Intermediate Index** is the intermediate component of the Bloomberg U.S. Government Index, which includes public obligations of the U.S. Treasury with at least one year to final maturity and publicly issued debt of U.S. government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. government. Source: Bloomberg Indices.

Important data provider notices and terms available at www.franklintempletondatasources.com. All data is subject to change.

Effective Duration is a duration calculation for bonds with embedded options. Effective duration takes into account that expected cash flows will fluctuate as interest rates change. Duration measures the sensitivity of price (the value of principal) of a fixed-income investment to a change in interest rates. The higher the duration number, the more sensitive a fixed-income investment will be to interest rate changes. The **30-day SEC yield** is calculated using the net income (interest and dividends) per share earned over a trailing 30-day period (annualized), divided by the fund's share price at the end of that period. It may not equal the fund's actual income distribution rate, which reflects the fund's past dividends paid to shareholders.

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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.

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