Franklin Low Duration Total Return Fund

Advisor Class: FLDZX Class A: FLDAX | **Commentary | as of December 31, 2025**

Key Takeaways

- **Markets**: The fourth quarter of 2025 (Q4) saw monthly shifts in market sentiment as uncertainties increased in the first part of the quarter. The US federal government went into a shutdown on October 1 as the US Senate was unable to pass a spending bill. This, among other things, delayed or canceled the publication of key economic data leading to a lack of clarity on the economic condition of the United States. The shutdown was lifted mid-November, and subsequent data showed that economic growth in the United States remained resilient. The US Federal Reserve delivered three consecutive 25-basis point cuts in Q4, helping market sentiment to improve in December. Fixed income volatility measures fell toward the end of the quarter, reaching their lowest level since 2021. The two-year UST yield decreased 14 bps to end the quarter at 3.47%.
- **Contributors**: Out-of-index exposure to collateralized mortgage obligations (CMOs) Security selection in high-yield (HY) corporate bonds.
- **Detractors**: Out-of-index holdings US Treasury Inflation-Protected Securities (TIPS). Security selection in senior-secured, floating-rate bank loans.
- **Outlook**: Continued uncertainty remains about future Fed policy, even between members, as reflected in a large distribution seen in the December Fed's scattered projections. In our view, the Fed has little room to cut rates substantially from here. Fixed income spreads remain at their multi-decade tights so we are looking for sector allocations to benefit from strong yield and interest-rate carry, but capital appreciation from spread tightening will be difficult in 2026.

Fund Characteristics

Fund Characteristics	Fund
Distribution Frequency	Monthly
30-Day SEC Yield (Advisor Class)—With Waiver	4.04%
30-Day SEC Yield (Advisor Class)—Without Waiver	3.76%

Performance Review

- **Sector allocations were a strong driver of overall performance** for the quarter led by our out-of-index exposure to CMOs, collateralized loan obligations, residential mortgage-backed securities (RMBS) and HY corporate bonds. Overweight positioning in commercial mortgage-backed securities (CMBS) also helped returns. In contrast, holdings of TIPS, which are not included in the benchmark, curbed performance for the period.
- **Security selection was also accretive to results** for the quarter led by selection in HY and investment-grade (IG) corporate bonds. However, this was partially offset by negative returns from selection in senior-secured, floating-rate bank loans.
- **Yield curve positioning hurt performance** with underweight exposure to the two-year area of the curve hindering results. This was partially offset by positive return contributions from an overweight to the five-year portion of the yield curve.

Outlook

- Progress on disinflation has stalled since April. Tariffs have pushed core goods prices higher, while core services excluding housing ("supercore") have reaccelerated above 3%. In 2026, we think inflation risks should be balanced, with the potential for upside surprises. Strong growth in the first half of the year and a more stable labor market can keep supercore sticky. On goods, much of the tariff effect is still ahead. Although the trade-weighted applied tariff rate is roughly 16%, effective, tariffs paid were under 11% as of July, explaining the muted goods price pass-through. We expect effective rates to rise in the coming months. While applied and effective tariff rates could fall if the Supreme Court rules against the administration on IEEPA tariffs, we think the White House will reimpose similar tariffs via Sections 122 and 301. That said, a partial recreation of IEEPA could limit upside risks to goods prices. Overall, gradual rent moderation combined with persistent services inflation should keep core personal consumption expenditures well above the Fed's 2% target through 2026.
- On interest rates, although the Fed has signaled one more cut for 2026, we continue to believe that so long as growth remains resilient and the expansion continues in line with our expectations, the Fed will remain on pause at least through Fed Chair Jerome Powell's term ending in May 2026, and potentially through 2026. That said, the Fed's reaction function does lean dovish, and any signs of labor market weakness could force additional "risk-management" cuts under Chair Powell or his successor. If our growth/inflation views are right and the Fed cuts fewer times than priced, we believe UST yields should drift higher from here. However, somewhat favorable demand-supply technicals (slower issuance of long-term USTs and the return of price-insensitive investors) could potentially limit how high yields might go in 2026.
- Investors continued to be more focused on yields provided by IG rather than looking at spreads which returned to multidecade tights by the end of the year. Credit fundamentals remain supportive, providing most IG issuers with substantial flexibility to manage through shifting economic and market conditions. While we believe IG corporate bonds continue to offer relatively safe yield, spread levels offer little cushion for further economic, market or geopolitical surprises. In our view, spreads are more likely to widen than tighten. Any significant move lower in yields may negatively impact demand, while an expected bump in new-issue supply could also put pressure on market technicals. This leads us to maintain a neutral stance on IG corporate credit while highlighting reasons for potential concern. We maintain a favorable view on the HY asset class but continues to believe that current valuations favor staying in higher-rated bonds. With spreads remaining at historically low levels, we don't expect returns to be driven by spread tightening. Therefore, coupon carry will continue to be the primary driver of returns. Rather than chase yields, we think a more prudent approach is to focus on limiting downside risk exposure.
- We have a neutral outlook on agency mortgage-backed securities over the medium-term with a neutral fundamental and favorable technical outlook for the sector. Although historically high money manager overweight is a potential hurdle for spread tightening, we anticipate increased demand from banks if the yield curve normalizes or regulatory uncertainty dissipates. Overall, we maintain a neutral view of the RMBS sector given rich valuations and our expectation for modest home price growth, but we continue to find value in certain subsectors. Given the flat credit curve, we favor opportunities near the top of the capital stack, such as recent issues of non-qualified mortgage and credit risk transfer bonds. Low unemployment,

modest wage growth and steady household formation should continue to support home prices and help contain delinquencies. Lack of inventory and lower affordability has hit home sales hard, and this trend is likely to continue into 2026. We continue to believe generic spreads do not currently reflect risks, namely higher rates and the potential for further labor market deterioration. Furthermore, underwriting standards are loosening, which suggests future refinancing may prove difficult without a lower interest rate environment. We see the CMBS credit curve as being too flat but sees CMBS as offering good opportunities for security selection when utilizing detailed loan-level analysis, particularly when considering relative value to other sectors. As such, we remain constructive on current positioning.

Average annual total returns and fund expenses (%) - as of December 31, 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	353612617	FLDZX	1.12	5.52	5.52	5.38	2.53	2.59	2.87	1.12	5.52	5.52	5.38	2.53	2.59	2.87	0.72	0.45	—	—	11/17/2004
Class A	353612690	FLDAX	1.07	5.29	5.29	5.15	2.31	2.35	2.66	-1.23	2.87	2.87	4.36	1.85	2.12	2.55	0.98	0.70	2.25	—	11/17/2004
Benchmark	—	—	1.16	5.35	5.35	4.77	1.97	2.09	—	1.16	5.35	5.35	4.77	1.97	2.09	—	—	—	—	—	—

Benchmark(s)

Benchmark =Bloomberg US Government & Credit (1-3 Year) 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 5/15/2008. Performance quotations have been calculated as follows: (a) for Advisor Class periods prior to 5/15/2008, 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 02/28/2026 without Board consent. Additional amounts may be voluntarily waived and/or reimbursed and may be modified or discontinued at any time without notice.

During periods of rising inflation, fund yields can vary significantly from month-to-month and may not be repeated.

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. **Low-rated, high-yield bonds** are subject to greater price volatility, illiquidity and possibility of default. **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. Derivative instruments** can be illiquid, may disproportionately increase losses, and have a potentially large impact on performance. 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

A **basis point (bp, or bps)** is one one-hundredth of one percent (1/100% or 0.01%).

A **collateralized loan obligation (CLO)** is a single security backed by a pool of debt.

Commercial mortgage-backed securities (CMBS) are a type of mortgage-backed security backed by commercial mortgages rather than residential real estate. CMBS tend to be more complex and volatile than residential mortgage-backed securities due to the unique nature of the underlying property assets.

A **Credit Risk Transfer (CRT)** is a channel for government-sponsored enterprises (GSEs) like Fannie Mae and Freddie Mac to transfer credit risk to private investors and away from taxpayers.

Personal consumption expenditures, or PCE, is a measure of price changes in consumer goods and services.

Residential mortgage-backed securities (RMBS) are a type of mortgage-backed debt obligation created from residential debt, such as mortgages, home-equity loans and subprime mortgages.

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/Credit Index**: 1-3 Year Component includes investment-grade, U.S. dollar-denominated, fixed-rate Treasuries, government-related (sovereign, agency, local authority and supranational) and corporate securities with at least one year up to, but not including, three years to final maturity.

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

Source: Bloomberg Indices.

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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