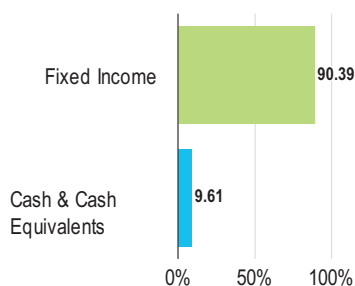


## Product Profile

### Product Details<sup>1</sup>

Fund Assets	\$703,013,479.93
Fund Inception Date	10/20/1987
Number of Holdings	1671
NASDAQ Symbol	FAUZX
Maximum Sales Charge	0.00
Base Currency	USD
Investment Style	Government
Benchmark	Bloomberg Barclays US Government (1-2 Year) Index
Lipper Classification	Ultra-Short Obligations Funds
Morningstar Category™	Short Government
Dividend Frequency	Accrued daily and paid monthly on the last business day

### Asset Allocation<sup>2</sup> Percent of Total



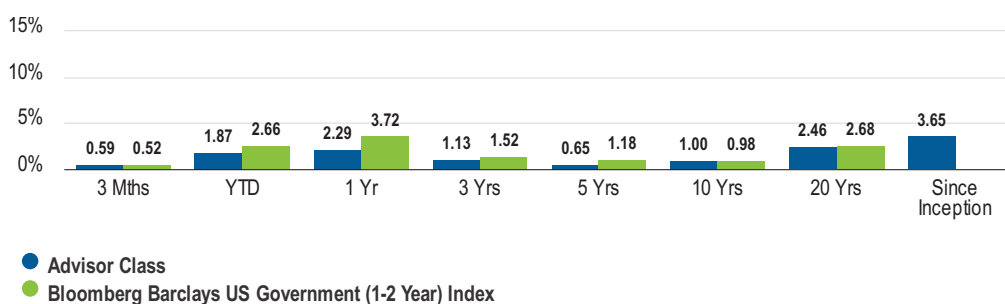
### Fund Description

The fund seeks a high level of current income, while providing lower volatility of principal than a fund that invests in fixed-rate securities. The fund invests predominantly in adjustable-rate mortgage securities (ARMS) that are issued or guaranteed by the US government, its agencies or instrumentalities.<sup>3</sup> The fund's investments may include securities issued by government-sponsored entities, such as Fannie Mae and Freddie Mac.<sup>4</sup>

### Performance Data<sup>5,6</sup>

#### Average Annual Total Returns<sup>7</sup> (%)

	3 Mths	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs	20 Yrs	Since Inception (10/20/1987)
Advisor Class	0.59	1.87	2.29	1.13	0.65	1.00	2.46	3.65
Bloomberg Barclays US Government (1-2 Year) Index	0.52	2.66	3.72	1.52	1.18	0.98	2.68	-



**Total Annual Operating Expenses**—With Waiver: 0.71% Without Waiver: 0.72%

**30-Day Standardized Yield<sup>8</sup>**—With Waiver: 2.03% Without Waiver: 2.01%

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 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 a fee waiver associated with any investment it makes in a Franklin Templeton money fund and/or other Franklin Templeton fund, contractually guaranteed through 02/29/2020. Fund investment results reflect the fee waiver; without this waiver, the results would have been lower.

1. All holdings are subject to change.

6. 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.

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

8. 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.

## Calendar Year Returns (%)

	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009
Advisor Class	1.02	0.26	0.34	-0.43	0.90	0.09	1.68	1.98	1.54	4.61
Bloomberg Barclays US Government (1-2 Year) Index	1.67	0.41	0.83	0.31	0.41	0.39	0.37	1.01	1.66	1.28

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Portfolio Manager Insight<sup>9</sup>

## Performance Review

## QUARTERLY KEY PERFORMANCE DRIVERS

HELPED	
	The Fund is a conservative strategy that invests primarily in high-quality agency adjustable-rate mortgages (ARMs) that are either explicitly or implicitly backed by the US government. During the quarter, the fund's focus on seasoned, shorter-maturity, high-quality ARM's that tend to be less sensitive to interest-rate changes supported performance. Over the period, we continued to focus on diverse, seasoned, post-reset Fannie Mae (FNMA) and Freddie Mac (FHLMC) ARM's with average coupons above 3% with larger loan counts. Secondary flows during the quarter declined significantly as post resets tend to be a bit orphaned with a preference toward fixed rate mortgages.
	—
	—
HURT	
	Underlying coupons continued to reset higher, although prepayment rate uncertainty clouds the ARM market outlook as they remain significantly elevated. We continue to be cautious about future prepayment speeds given the significant rally in mortgage rates and with securities trading at significant premiums. The outlook for prepayments has created caution in the sector and led to a decrease in prices ranging from 10-15 basis points (bps). With a shift toward a flatter yield curve, and absolute prepayments remaining elevated, we remain cautious going forward. We do believe that with borrowers having experienced a full year of mortgages resetting upward, a burnout effect could offset some of the refinance incentive which would help lower prepayment rates at some point in the future. Hence we have been favoring those ARM's, linked to the LIBOR index which would have slower speeds relative to those indexed off of CMT. Given the high probability of elevated speeds for the foreseeable future in a market where the premiums are quite significant, we have retained a slightly higher cash allocation.
	—
	—

## Outlook &amp; Strategy

- There is quite a contrast between real U.S. economic data or “hard data” which is holding up fairly well, and sentiment related data or “soft data,” which has weakened substantially in recent months. This is an important distinction in a world where the Fed seems to be more focused on soft data in their evaluation of downside risks and where fixed income markets appear to be driven more by central bank policy than fundamentals.
- Soft data surrounding business sentiment has been notably more negative recently. We have seen a rise in uncertainty related to trade war tensions and geopolitical risks, filtering into business confidence and having some impact on manufacturing activity and business investment. Yet, the decline in hard data, or real economic activity, has been only moderate.
- Consumption has been fairly solid, and we see reason to think it will remain so. Income is a large driver of consumption and labor markets remain quite strong, providing job gains as well as wage gains. Additionally, low interest rates are supporting home prices and providing refinancing opportunities, lowering mortgage payments for many consumers. The full benefit of the Fed's recent rate cuts will be felt with a lag well into 2020, providing added support to an economy we view as solid.

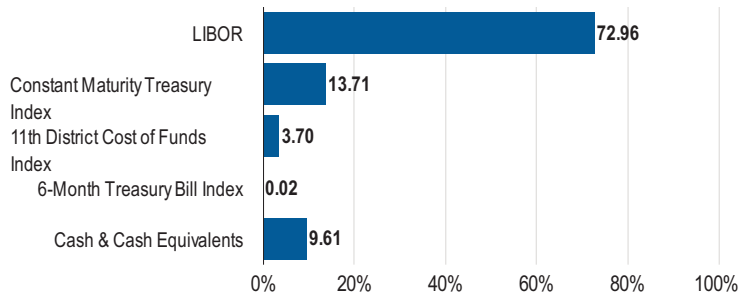
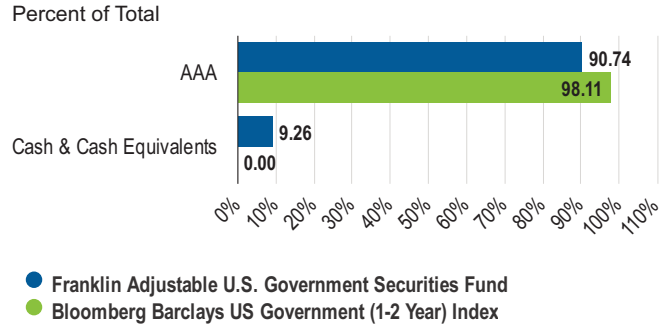
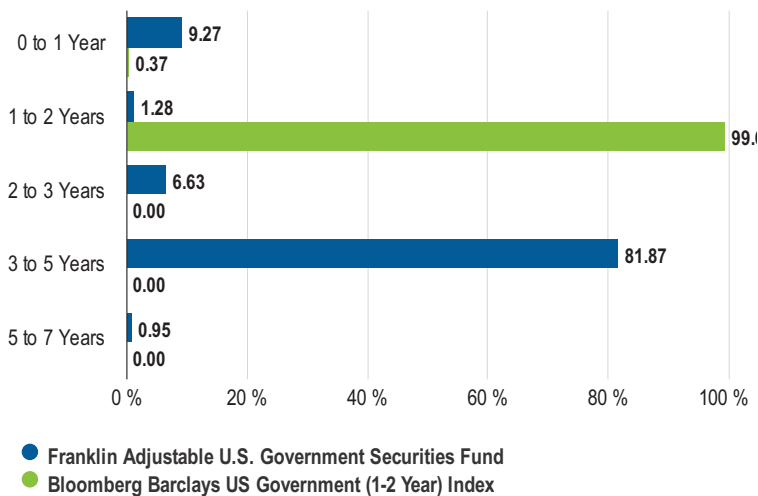
9. The information provided is not a complete analysis of every material fact regarding any country, market, industry, security or fund. Because market and economic conditions are subject to change, comments, opinions and analyses are rendered as of the date of this material and may change without notice. 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<sup>2,10,11</sup>

	Portfolio	Bloomberg Barclays US Government (1-2 Year) Index
Average Duration	0.72 Yrs	1.49 Yrs
Average Weighted Maturity	3.57 Yrs	1.53 Yrs
Annual Turnover Ratio (10/31/2018)	11.39%	-

10. Turnover Ratio is as of the fund's fiscal year-end.

11. 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 Diversification<sup>2</sup>Sector Allocation  
Percent of TotalCredit Quality Ratings vs. Bloomberg Barclays US Government (1-2 Year) Index<sup>12</sup>Maturity Weightings vs. Bloomberg Barclays US Government (1-2 Year) Index  
Percent of Total

## Supplemental Performance Statistics

Supplemental Risk Statistics<sup>13,14</sup>

	3 Yrs	5 Yrs	10 Yrs
Standard Deviation (%)	0.43	0.45	0.53
Tracking Error (%)	0.62	0.64	0.67
Information Ratio	-0.63	-0.83	0.04
Sharpe Ratio	-0.92	-0.67	0.93

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## Investment Philosophy

- The fund seeks a high level of current income, while providing lower volatility of principal than a fund that invests in fixed-rate securities
- The fund invests predominantly in adjustable-rate mortgage securities (ARMS), which are issued or guaranteed by the U.S. government, its agencies or instrumentalities<sup>1</sup>

12. 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.

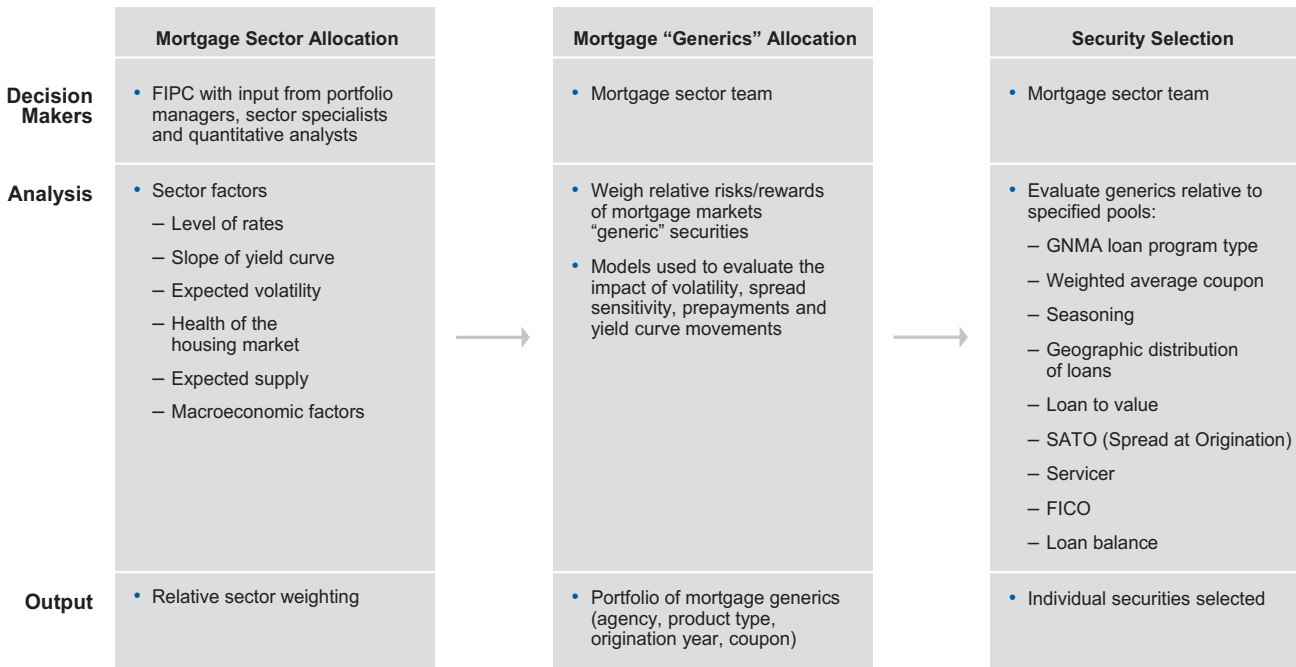
13. Information Ratio and Tracking Error information are displayed for the product versus the Bloomberg Barclays US Government (1-2 Year) Index.

14. 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).

- The fund's investment management team focuses on seasoned ARMS that may have been through multiple interest rate cycles and are therefore less sensitive to rate changes
- The fund does not invest in non-agency mortgages, mortgage derivatives or sub-prime residential mortgage-backed securities
- Historically a shorter duration MBS strategy, where ARM resets are laddered throughout the portfolio

## Investment Process

The Mortgage Investment Process Consists of Three Steps:



## Investment Team

Portfolio Manager	Years with Firm	Years Experience
Paul Varunok, SVP / Head of Mortgage Portfolio Management	18	27
Roger Bayston, CFA, EVP, Director of Quantitative and Fintech Strategies	28	33

**Annual Turnover Ratio:** Percentage of a fund's holdings replaced with other holdings during a fund's most recent full fiscal year.

**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. Interest rate movements, unscheduled mortgage prepayments and other risk factors will affect the fund's share price and yield. Bond prices generally move in the opposite direction of interest rates. As the prices of bonds in a fund adjust to a rise in interest rates, the fund's share price may decline. Changes in the financial strength of a bond issuer or in a bond's credit rating may affect its value. 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](http://franklintempleton.com). Please carefully read a prospectus before you invest or send money.*

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2. Information is historical and may not reflect current or future portfolio characteristics. All holdings are subject to change.
3. 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.
4. Although US government-sponsored entities may be chartered or sponsored by Acts of Congress, their securities are neither issued nor 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 vary with market conditions.
5. Effective 05/15/2008, 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.



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