

Franklin Total Return Fund

Advisor Class: FBDAX Class A: FKBAX

Commentary | as of September 30, 2025

Key Takeaways

- **Markets** Market sentiment improved across the third quarter of 2025 (Q3) due to a partial resolution of some of the outstanding trade policy concerns. At its September meeting, the US Federal Reserve (Fed) cut the fed funds rate by 25 basis points (bps) and signaled that more cuts were likely to come by the end of this year. This bolstered markets which viewed that the cut was addressing some of the weakening economic measures, such as the status of the US labor market. Fixed income spread markets performed well as corporate bond spreads reached multidecade lows by the end of the quarter, per Bloomberg. Other fixed income sectors, such as securitized, also posted positive returns. The benchmark 10-year US Treasury yield fell eight bps to end the quarter at 4.15%.
- **Contributors:** Overweight corporate credit sectors. Overweight agency mortgage-backed securities (MBS).
- **Detractors:** Security selection in corporate credit sectors, MBS, and commercial MBS (CMBS)
- **Outlook:** There is high uncertainty about future Fed policy, even between members, as reflected in a large distribution seen in the Fed's scattered projections for the path of fed funds for the remainder of the year. In our view, this level of uncertainty has the potential to spur volatility in the UST market..

Performance Review

- Sector allocations were strong drivers of returns for the quarter led by an overweight to investment-grade (IG) corporate bonds and out-of-index holdings of high-yield (HY) corporate bonds, senior secured floating-rate banks loans and collateralized loan obligations (CLOs). Additionally, securitized sectors helped results with an overweight to Agency MBS and out-of-index holdings of RMBS, commercial MBS (CMBS) and agency collateralized mortgage obligations (CMOs) lifting results. Overweight positioning in sovereign emerging-market (EM) debt added to performance.
- Security selection curbed returns with negative security selection in CMBS, IG and HY corporate bonds, and MBS. This was partially offset by positive return contributions from selection in CLOs.
- Yield curve exposure hindered performance with underweight exposure to the 20-year area of the curve.

Outlook

- The Fed has been struggling to balance its dual mandate—maximum employment and price stability—as stagflation (rising inflation with slowing growth) becomes a real possibility. The Fed has chosen to prioritize employment over inflation, consistent with its historical tendency to intervene when growth slows. US trade policy remains a wild card, adding to uncertainty in the market, even if tariffs do not cause a permanent lift in inflation. Strong consumer spending and supportive fiscal policy mean the current economic environment is not likely to return to disinflation. In our view, tariffs are expected to cause a moderate, one-off uptick in inflation, of roughly 1–1.5 percentage points. The overall impact should be limited due to the small share of imports in the US economy. In our view, this level of uncertainty has the potential to spur volatility in the UST market. We continued to be biased toward higher UST yields, especially in intermediate and longer-term maturities, given the Fed's inability to cut rates deeply due to inflation and increased issuance of USTs needed to fund increasing deficits.
- IG corporate bond spreads have moved tighter year-to-date (YTD), per Bloomberg, driven by investor demand for historically attractive yields, as well as diminished market concerns about the potential negative impact of US trade policies. After some volatility earlier in 2025, credit spreads are again well inside longer-term averages and are close to their tightest levels in the past 25 years. 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 again offer little cushion for further economic, market or geopolitical surprises. In our view, spreads will likely remain in a trading range but are more likely to widen than tighten. Yields at or around current levels could continue to support demand, but there is some risk that lower yields, due to either aggressive Fed easing or weaker economic data, may begin to negatively impact market technicals. This leads us to maintain a neutral stance on IG credit while highlighting potential concerns on current valuation levels.
- For securitized sectors, we have a generally neutral stance. In agency MBS we have seen spreads tighten along with a sharp decline in realized volatility, per Bloomberg. MBS spread metrics are tight to their long-term average and fair relative to other high-quality fixed income sectors. Technical conditions in the market remain strong as YTD issuance has lagged expectations, partially due to higher mortgage rates and lower housing affordability. So far, money managers have absorbed a large share of excess supply, but further demand could be limited given the current size of their overweight to the sector, so additional demand may depend on flows into the funds. At current valuations, we have a neutral stance on the MBS sector. This is predicated on tighter spreads, prepayment risk in the higher coupon securities and a neutral fundamental outlook, offset by a favorable technical outlook, expectation of increased bank demand and low net supply in the market. We continue to hold a favorable view of mortgage credit. Our view stems from the significant accumulation of home equity in the past five years, lower household leverage and perennial inventory shortages. These dynamics could support the RMBS sector. Within the CMBS sector, we are finding pockets of value, but we are being very selective in what risk/reward characteristics we are focused on.
- Overall, we do think it's a good time to consider putting cash to work in the shorter-duration segments of the market, despite the tightness of spreads and the prospective rise in volatility..

Fund Characteristics

Fund Characteristics	Fund
Distribution Frequency	Monthly
30-Day SEC Yield (Advisor Class)—With Waiver	4.26%
30-Day SEC Yield (Advisor Class)—Without Waiver	4.05%

Average annual total returns and fund expenses (%) - as of September 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	353612849	FBDAX	2.10	6.06	3.06	5.41	-0.06	1.86	4.14	2.10	6.06	3.06	5.41	-0.06	1.86	4.14	0.69	0.49	—	—	8/3/1998
Class A	353612856	FKBAX	2.05	5.90	2.82	5.18	-0.29	1.62	3.88	-1.83	1.93	-1.00	3.83	-1.04	1.23	3.74	0.94	0.74	3.75	—	8/3/1998
Benchmark	—	—	2.03	6.13	2.88	4.93	-0.45	1.84	—	2.03	6.13	2.88	4.93	-0.45	1.84	—	—	—	—	—	—

Benchmark(s)

Benchmark =Bloomberg US Aggregate 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 8/3/1998. Performance quotations have been calculated as follows: (a) for Advisor Class periods prior to 8/3/1998, 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. Duration is a measure of the sensitivity of a bond's price to changes in interest rates. 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 US Aggregate Index is comprised of investment-grade, U.S. dollar-denominated government, corporate, and mortgage- and asset-backed issues having at least one year to maturity. Source: Bloomberg Indices. Important data provider notices and terms available at www.franklintempletondatasources.com. All data is subject to change. 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. 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.