

# Franklin High Yield Municipal SMA

Commentary | as of June 30, 2025

## Key Takeaways

- **Markets:** There were large swings in financial market sentiment across the second quarter of 2025. In early April, US President Donald Trump announced significant increases in US tariff rates as part of his "Liberation Day." Subsequently, a temporary pause (in many cases 90 days) in increased levies helped calm some of the market nerves. The passage of the "One Big Beautiful Bill" spending package after quarter-end further reduced the uncertainties that had been a strong headwind to municipal (muni) bond markets as it affirmed the tax-exempt status of muni securities.
- **Contributors:** There were no significant contributors to performance during the period.
- **Detractors:** Overweight bonds with no external credit rating. Overweight revenue-related muni bonds. Overweight duration.
- **Outlook:** Municipal bond valuations continue to appear attractive to us, particularly on a tax-adjusted basis, with yields near multi-year highs. In a more challenging environment, strong bottom-up research and disciplined security selection will be essential to identifying relative value and potentially preserving portfolio quality.

## Performance Review

- Our overweight to bonds that do not have external credit ratings detracted from relative returns as lower-quality assets generally fared worse than their higher-quality counterparts during the period.
- Sector exposure also curbed results. We focus on revenue-related bonds, including pre-paid gas structured bonds and muni bond real estate issues from land development and housing projects, which fared worse during the quarter. However, security selection within the sectors contributed to performance.
- Our overweight duration detracted from returns as muni yields rose in comparison to US Treasury yields on the longer end of the curve over the quarter.

## Outlook

- We still feel that technical conditions in the market favor investors. Fund flows have moved to be positive, and the additional supply of munis has been well absorbed. The summer months typically see an increase in coupon payments and maturing bonds, which will require reinvestment that should provide a strong base to support valuations.
- Fundamentals remain broadly stable, with Moody's reporting that credit upgrades continued to outpace downgrades. However, as the economy slows and inflationary pressures ease, tax revenue growth at the state and local level is expected to moderate, placing greater importance on credit selectivity going forward.
- Municipal bond valuations continue to appear attractive to us, particularly on a tax-adjusted basis. In a more challenging environment, strong bottom-up research and disciplined security selection will be essential to identifying relative value and potentially preserving portfolio quality.

## Portfolio Characteristics

Effective Duration

## Portfolio

7.97 Years

## State / U.S. Territory Allocation (% of Total)

| State                   | Portfolio |
|-------------------------|-----------|
| Florida                 | 17.05     |
| Illinois                | 12.19     |
| California              | 10.96     |
| Texas                   | 7.16      |
| Puerto Rico             | 6.71      |
| New York                | 5.80      |
| Alabama                 | 5.33      |
| Tennessee               | 4.83      |
| Other                   | 28.09     |
| Cash & Cash Equivalents | 1.87      |

Average annual total returns (%) - as of June 30, 2025-PRELIMINARY

| Product            | 3-Mo* | 6-Mo* | YTD*  | 1-Yr  | 3-Yr | 5-Yr | 10-Yr | 15-Yr | 20-Yr | 25-Yr | Inception | Inception Date |
|--------------------|-------|-------|-------|-------|------|------|-------|-------|-------|-------|-----------|----------------|
| Net of Fees        | -1.04 | -1.56 | -1.56 | -0.67 | —    | —    | —     | —     | —     | —     | 5.01      | 10/31/2022     |
| Pure Gross of Fees | -0.67 | -0.83 | -0.83 | 0.82  | —    | —    | —     | —     | —     | —     | 6.58      | 10/31/2022     |
| Benchmark          | -0.12 | -0.35 | -0.35 | 1.11  | —    | —    | —     | —     | —     | —     | 4.51      | —              |

\*Cumulative total returns

Benchmark(s)

Benchmark =Bloomberg Municipal Bond Index

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**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.

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