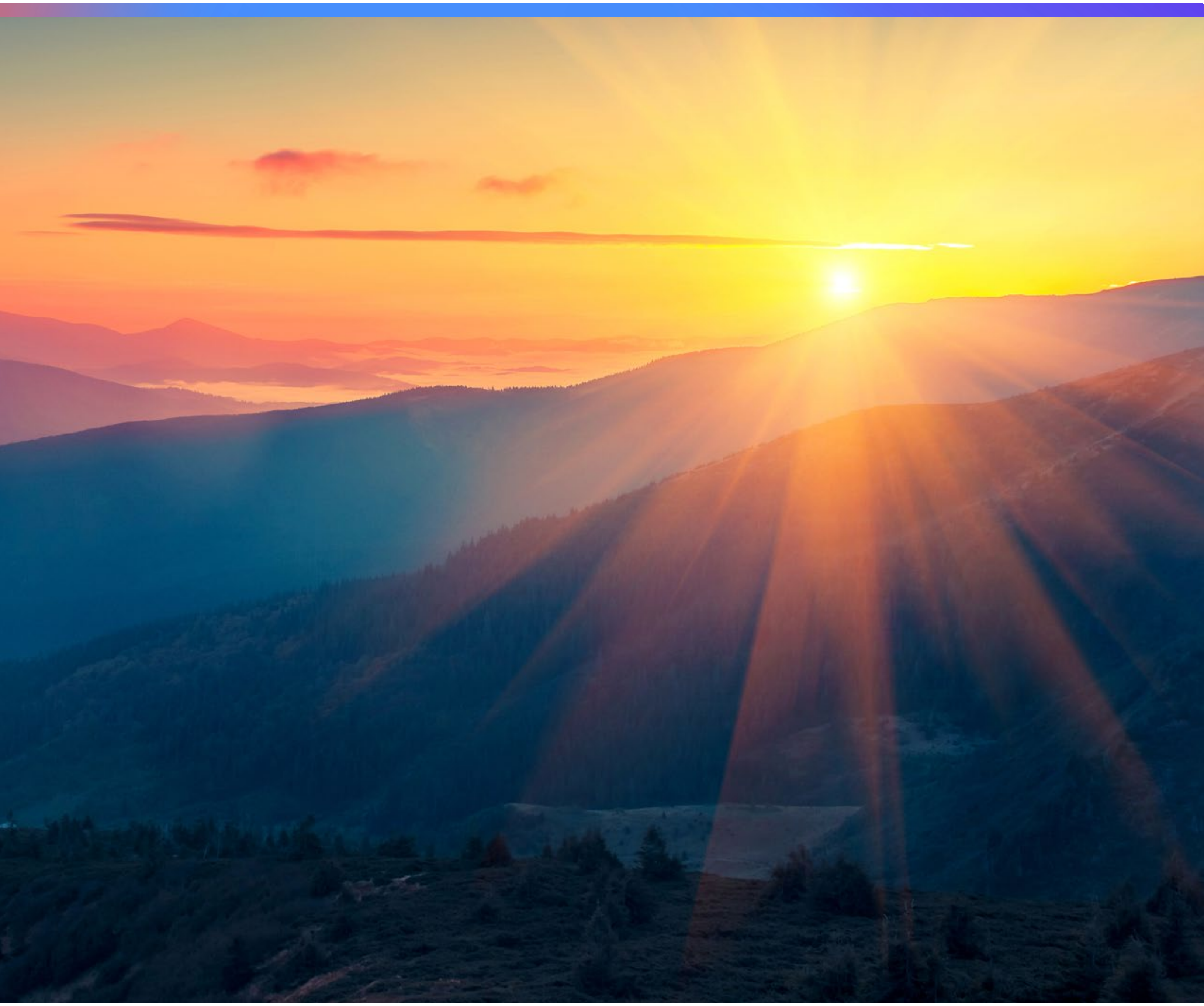
FRANKLIN TEMPLETON

# Seize the yield

## Taking a fresh look at fixed income



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# Seize the yield

A rapid rise in interest rates since early 2022 has helped rejuvenate fixed income yields to levels not seen in more than a decade. Today's higher yields have unlocked potential opportunities for investors to collect attractive income, generate better long-term total returns, and add diversification to their portfolios.

Investors who are willing to take a fresh look at fixed income may see compelling opportunities that have emerged across the fixed income spectrum.

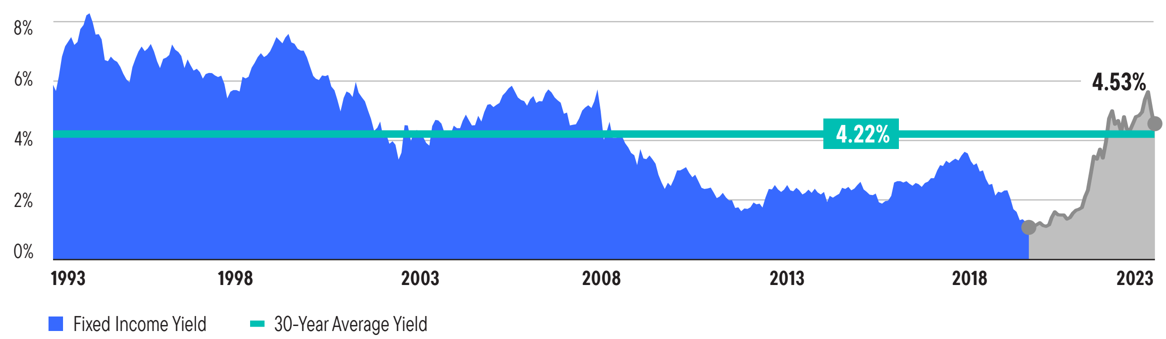
# 1 | Higher yields have recharged income generation

## Yields have reemerged from a decade-long slumber

The amount of income an investment pays is typically measured by its yield. After bottoming out just above 1% during the COVID-19 pandemic, yields rose sharply and have hovered above the long-term average for more than a year now.

**Historical Yield of the Bloomberg US Aggregate Bond Index**

For the 30-Year Period Ended December 31, 2023



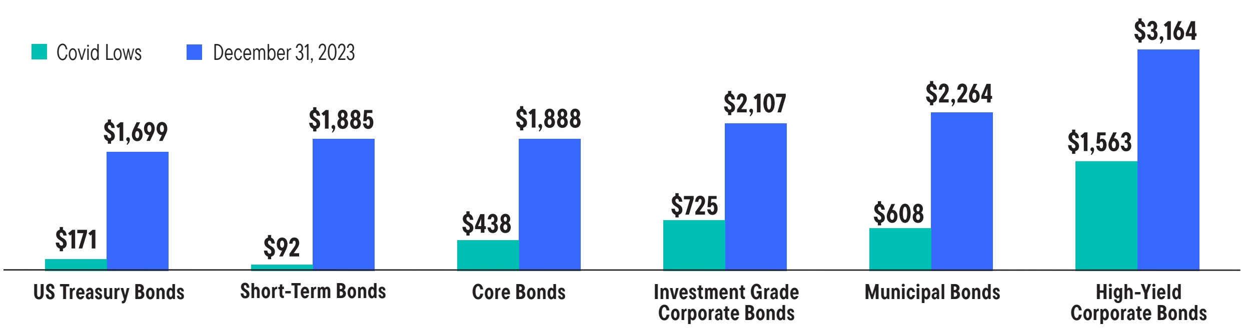

Source: Bloomberg. Yield is represented by the yield-to-worst for the Bloomberg US Aggregate Bond Index. Yield-to-worst is the lowest possible yield that can be received on a bond without the issuer actually defaulting. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged, and one cannot invest directly in an index

## The income is back in fixed income

The sharpest rise in yields since the early 1980s has resulted in a tectonic shift for income generating opportunities across the fixed income spectrum.

**Monthly Income from a $500,000 Investment**

Covid Lows and December 31, 2023




*This chart is for illustrative purposes only and does not reflect the performance of any Franklin Templeton fund. Past performance does not guarantee future results.*

*Treasuries, if held to maturity, offer a fixed rate of return and fixed principal value; their interest payments and principal are guaranteed.*

Source: Bloomberg. Calculated based upon a hypothetical $500,000 investment into each of the of the following Bloomberg indexes: US Treasury (US Treasury Bonds), 1-3 Year US Government/Credit (Short-Term Bonds), US Aggregate Bond (Core Bonds), US Corporate (Investment Grade Corporate Bonds), Municipal Bond (Municipal Bonds), and US Corporate High Yield (High-Yield Corporate Bonds). Covid lows are represented by the lowest month-end yield for each index between January 30, 2020 and May 5, 2023, the period the World Health Organization classified COVID-19 as a global health emergency. Municipal Bonds income is based on the tax-equivalent yield, adjusted for the maximum 40.8% top marginal rate for net investment income (includes 3.8% Net Investment Income Surtax from the Affordable Care Act). Indexes are unmanaged, and one cannot invest directly in an index.

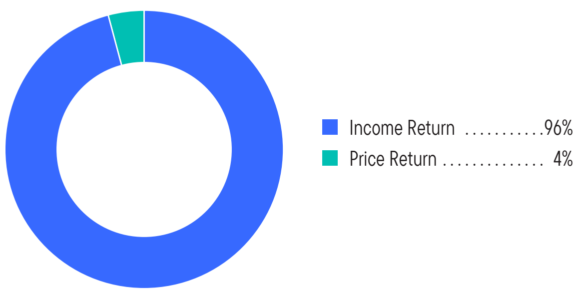
# 2 | Increased income supports long-term total returns

## Historically, income has been the biggest contributor to long-term fixed income total returns

Fixed income returns are derived from two sources: the interest paid, or income return, and any positive or negative price changes, or price return. Historically, income returns have made up 96% of fixed income total returns, which is one reason why today's higher yields are so encouraging for fixed income investors.

**Percent of Total Return from Income vs. Price Returns of the Bloomberg US Aggregate Bond Index**

1976 – 2023



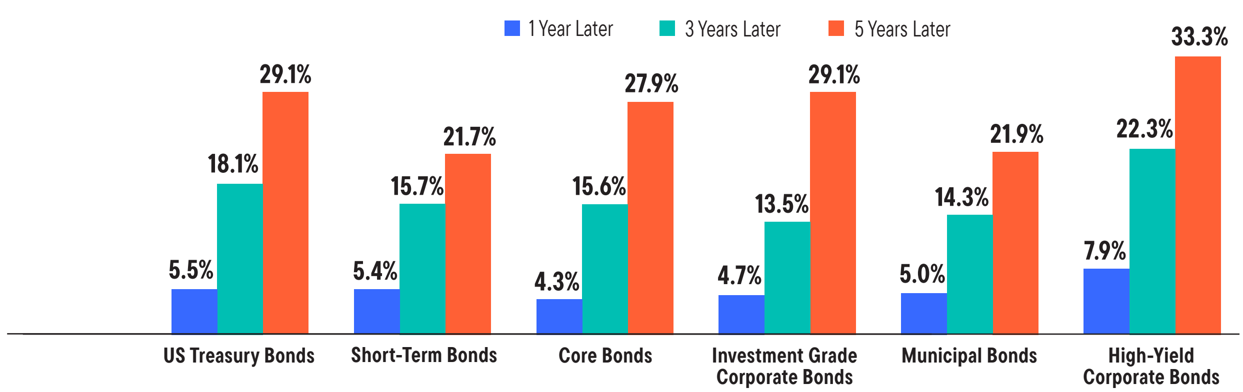

Source: Bloomberg. Measured by the annual income and price return contributions to the total return of the Bloomberg US Aggregate Bond Index. Indexes are unmanaged, and one cannot invest directly in an index.

## Higher recent yields offer attractive return potential

Yields have historically been one of the best gauges of forward returns for fixed income. When yields have been near recent levels, defined as within half a percent above or below the December 31, 2023 yield, forward cumulative total returns 1-, 3- and 5- years later have been attractive.

**Historical Total Cumulative Returns at Recent Yield Levels**

January 1, 1999 - December 31, 2023




| 12/31/2023 Yield | 4.08% | 4.52% | 4.53% | 5.06% | 5.43% | 7.59% |
|---|---|---|---|---|---|---|

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*Treasuries, if held to maturity, offer a fixed rate of return and fixed principal value; their interest payments and principal are guaranteed.*

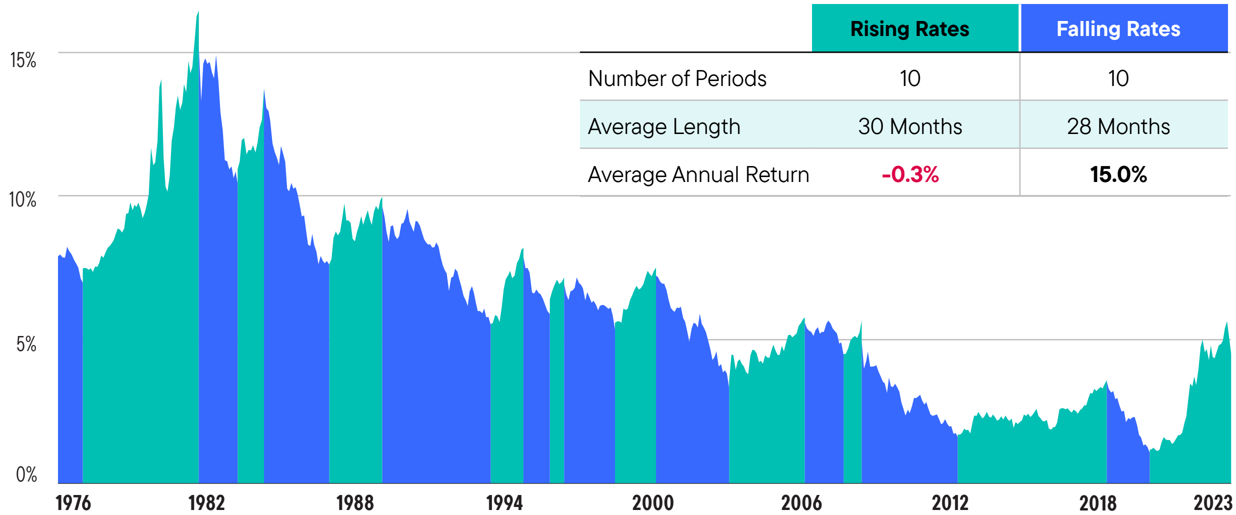
Source: Bloomberg. Returns represent the average cumulative returns for the 1-, 3- and 5-year periods whenever the yield, as represented by the yield-to-worst, was within 50 basis points of the 12/31/2023 yield for each fixed income sector. There is no assurance that any estimate, forecast or projection will be realized. Municipal Bonds yield represents a tax-adjusted yield-to-worst assuming the maximum 40.8% top marginal rate for net investment income (includes 3.8% Net Investment Income surtax from the Affordable Care Act). Bloomberg indexes: US Treasury (US Treasury Bonds), 1-3 Year US Government/Credit (Short-Term Bonds), US Aggregate Bond (Core Bonds), US Corporate (Investment Grade Corporate Bonds), Municipal Bond (Municipal Bonds), and US Corporate High Yield (High-Yield Corporate Bonds). Indexes are unmanaged, and one cannot invest directly in an index.

# 3 | An end to the rate hike cycle may create a tailwind

## Changes in interest rates are cyclical

Interest rates tend to rise and fall in cycles, and while income is the dominant driver of returns over the long-term, historically falling interest rate periods have significantly boosted fixed income returns over the short-term. After enduring a steep rising cycle since mid-2020, could interest rates now be poised to fall?

**Historical Rising/Falling Interest Rate Cycles for the Bloomberg US Aggregate Bond Index**
1976 – 2023



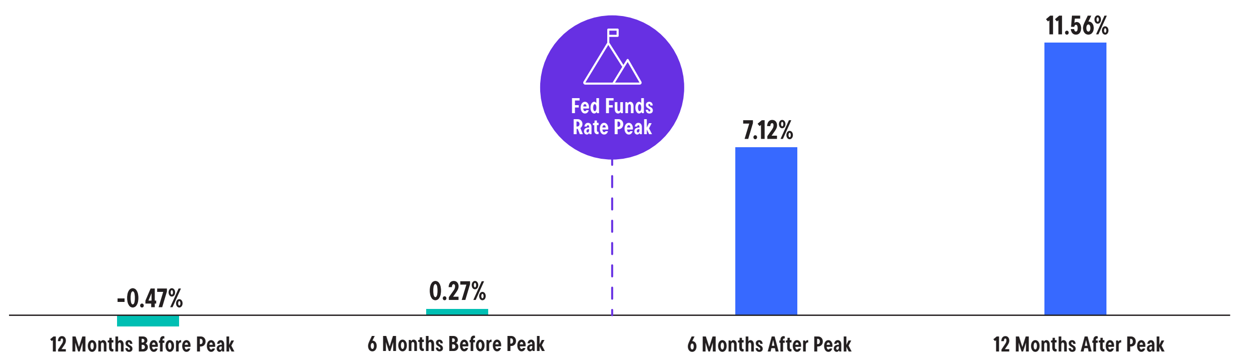

| | Rising Rates | Falling Rates |
|---|---|---|
| Number of Periods | 10 | 10 |
| Average Length | 30 Months | 28 Months |
| Average Annual Return | -0.3% | 15.0% |

Source: Bloomberg. Rising rates are defined as periods when the Bloomberg US Aggregate Bond Index yield-to-worst rose at least 100 basis points, or 1%, without a sustained decline for at least 6 months. Falling rates are defined as periods when the same index fell at least 100 basis points, or 1%, without a sustained increase for at least 6 months. Indexes are unmanaged, and one cannot invest directly in an index.

## Returns accelerate once the Fed stops raising rates

To fight persistently high inflation, the Federal Reserve (Fed) has raised the federal funds rate 11 times since early 2022. But many are now watching closely to see if the Fed may be finished hiking for this cycle. Historically, fixed income returns have accelerated in the 6 and 12 months following a peak in the federal funds rate.

**Average Bloomberg US Aggregate Bond Index Returns Before and After the Fed Funds Rate Peaks**
1994 – 2019




Sources: Macrobond, Bloomberg. Represents the average 6- and 12-month returns of the Bloomberg US Aggregate Bond Index before and after Fed Funds rate peaks on 2/1/1995, 5/16/2000, 6/29/2006, and 12/20/2018. Indexes are unmanaged, and one cannot invest directly in an index.

# 3 | An end to the rate hike cycle may create a tailwind (continued)

## Holding cash may be costly once rates peak

When rates peak, certificates of deposit (CDs) can look like an attractive investment option. However, since CDs typically only pay income and do not benefit from price appreciation when interest rates fall, they have often been the worst performing fixed income asset class the year after rates peak.

### Growth of a $100,000 Investment 1-Year Following Peak CD Rates

| 1-Year Periods Ended | CDs | Short-Term Bonds | Municipal Bonds | Core Bonds | Investment-Grade Corporate Bonds |
|---|---|---|---|---|---|
| July 31, 1985 | $111,240 | $117,527 | $120,083 | $123,913 | $127,248 |
| March 31, 1990 | $109,210 | $110,633 | $110,552 | $112,339 | $111,753 |
| January 31, 1996 | $105,690 | $110,395 | $115,053 | $116,947 | $120,480 |
| August 31, 2001 | $105,530 | $110,028 | $110,193 | $112,354 | $113,761 |
| August 31, 2007 | $103,790 | $105,418 | $102,298 | $105,261 | $104,321 |
| May 31, 2020 | $101,000 | $104,573 | $103,978 | $109,415 | $110,026 |

Lowest returning asset class

CDs are insured by the Federal Deposit Insurance Corporation for up to the current maximum limit of $250,000 and offer a fixed rate of return.

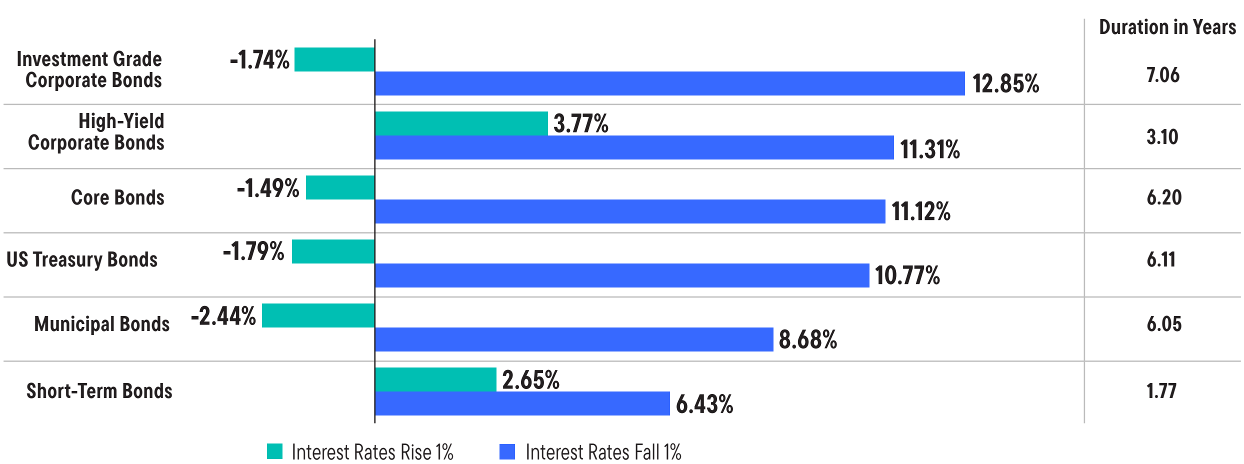
Sources: Bloomberg, Bankrate. Peak CD rates are defined as the highest national average rate for 1-year CDs following a rise of at least 100 basis points, or 1%, from prior lows. The following Bloomberg indexes were used to represent the fixed income sectors: 1-3 Year US Government/Credit (Short-Term Bonds), Municipal Bond (Municipal Bonds), US Aggregate Bond (Core Bonds), US Corporate (Investment Grade Corporate Bonds), Indexes are unmanaged, and one cannot invest directly in an index.

## Where will interest rates go from here?

It's only in hindsight that we can truly know when a rising interest rate cycle will pivot to a falling rate cycle. The following chart shows how different fixed income sectors would be expected to perform given a 1% rise or fall in interest rates from their December 31, 2023 level. For some investors, the upside potential if interest rates were to fall may outweigh the risk should rates continue to rise.

### Total Return Impact of a 1% Rise or 1% Fall in Interest Rates

As of December 31, 2023



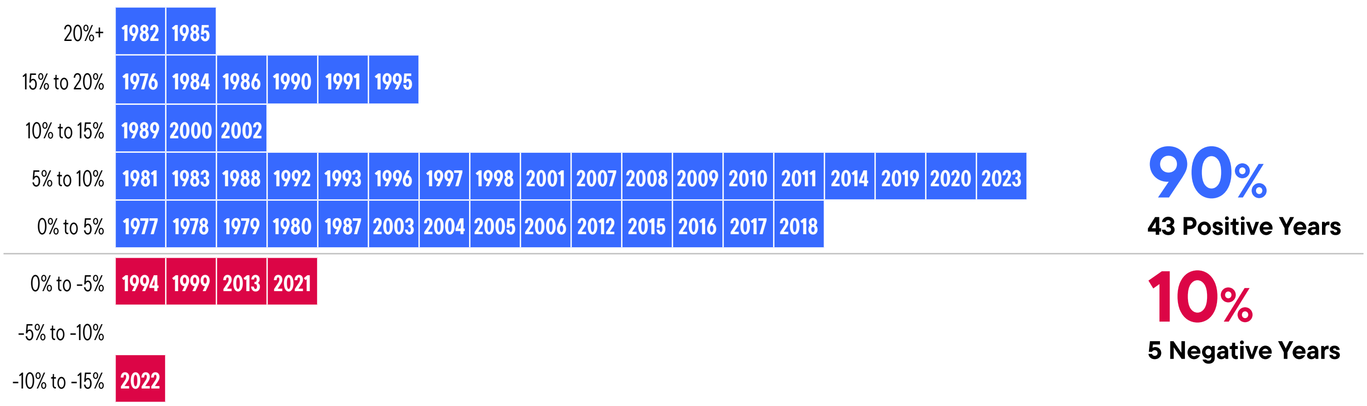

Source: Bloomberg. Measures the sensitivity to interest rates of different fixed income sectors. Calculated based on the yield, convexity and duration as of 12/31/2023, assuming a 1% parallel shift up or down in the yields of each representative index. There is no assurance that any estimate, forecast or projection will be realized. Bloomberg indexes: US Corporate (Investment Grade Corporate Bonds), US Corporate High Yield (High-Yield Corporate Bonds), US Aggregate Bond (Core Bonds), US Treasury (US Treasury Bonds), Municipal Bond (Municipal Bonds) and 1–3 Year US Government/Credit (Short-Term Bonds). Indexes are unmanaged, and one cannot invest directly in an index.

# 4 | Market uncertainty underscores the need for portfolio ballast

## Fixed income returns have been positive most years

Dating back to 1976, fixed income returns have been positive 90% of the time. The propensity of fixed income investments to deliver positive returns has often provided a stabilizing effect for portfolios with other volatile holdings, such as equities.

**Calendar Year Returns for the Bloomberg US Aggregate Bond Index**
1976 – 2023



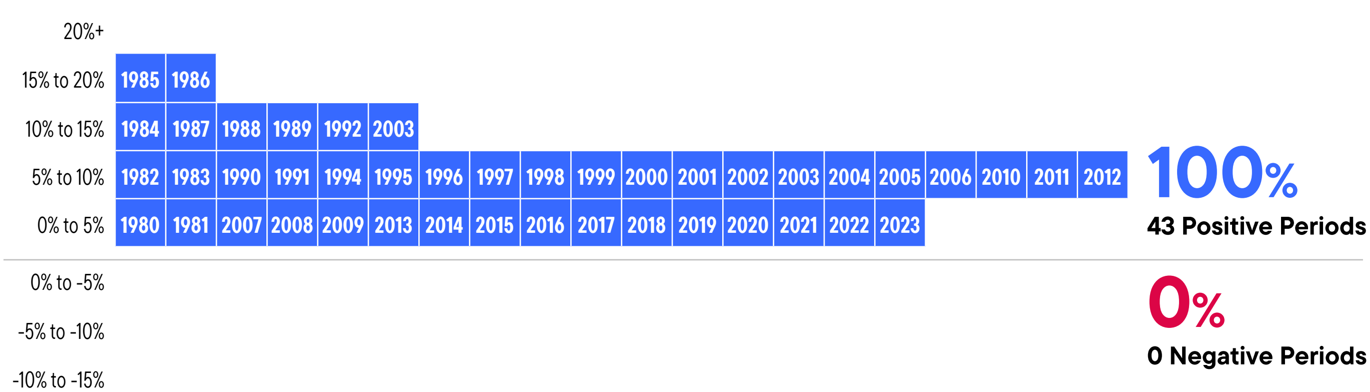

*This chart is for illustrative purposes only and does not reflect the performance of any Franklin Templeton fund. Past performance does not guarantee future results.*

Sources: Bloomberg. Morningstar Direct. Calendar year total returns of the Bloomberg US Aggregate Bond Index. Indexes are unmanaged, and one cannot invest directly in an index.

## 5-year fixed income returns have been positive 100% of the time

When looking at 5-year rolling returns, there haven't been any negative periods for fixed income since 1976. Today's elevated yields may help reinvigorate fixed income's traditional role as a portfolio diversifier.

**Rolling 5-Year Returns for the Bloomberg US Aggregate Bond Index**
1980 – 2023




*This chart is for illustrative purposes only and does not reflect the performance of any Franklin Templeton fund. Past performance does not guarantee future results.*

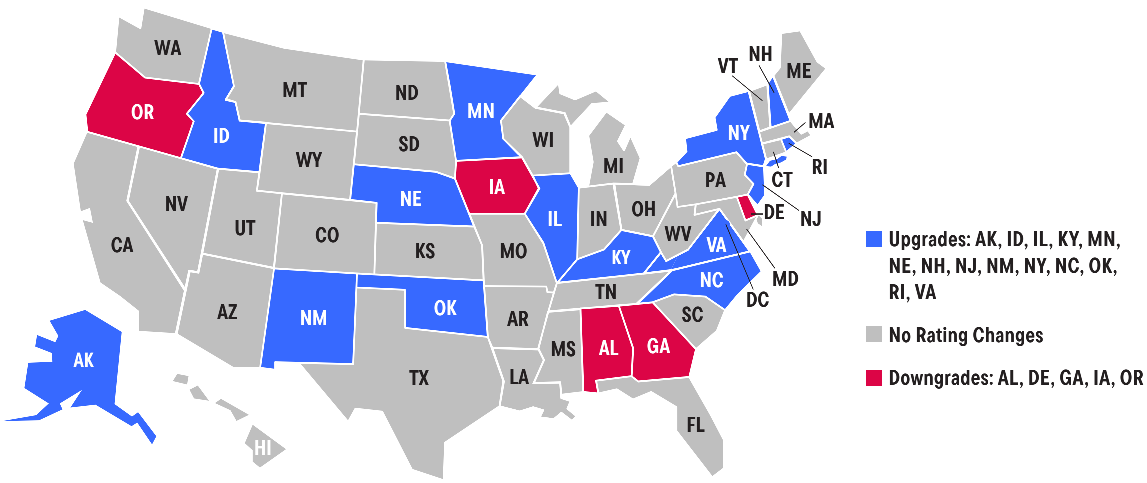
Sources: Bloomberg. Morningstar Direct. 5-year rolling calendar year average annual returns of the Bloomberg US Aggregate Bond Index. Each year displayed represents the 5-year period ended December 31 of that year. Indexes are unmanaged, and one cannot invest directly in an index.

# 5 | Indicators point to an opportunity in munis

## Many states have received credit rating upgrades

Many states are in much better financial condition today than they were during the depths of the COVID-19 pandemic and may be in a better position to withstand an economic slowdown.

**Change in Ratings at State-Issuer Level**
2021 – 2023




Sources: Moody's, Standard and Poor's, Fitch Ratings, Kroll Bond Ratings, Bloomberg. Ratings changes based on most recent fiscal year data available for each state compared to ratings as of 12/31/2021.

## What will happen when the current muni outflow cycle comes to an end?

Starting in 2022 and continuing through most of 2023, muni bond funds experienced the longest and most significant outflows since the Global Financial Crisis. Historically, sizeable muni inflow cycles and stronger performance have followed large outflow cycles.

| | Outflow Period Statistics | | | Following Inflow Period Statistics | | |
|---|---|---|---|---|---|---|
| **Quarterly Outflow Cycle** | **Number of Quarters** | **Total Outflows $ (Billions)** | **Performance During Outflow Cycle** | **Number of Quarters** | **Total Inflows $ (Billions)** | **Performance During Inflow Cycle** |
| 4Q 2008 | 1 | -$13.8 | 0.74% | 7 | $104.8 | 20.62% |
| 4Q 2010 – 2Q 2011 | 3 | -$41.1 | 0.07% | 7 | $70.3 | 13.53% |
| 2Q 2013 – 4Q 2013 | 3 | -$66.4 | -2.83% | 5 | $38.4 | 10.16% |
| 2Q 2015 – 3Q 2015 | 2 | -$3.9 | 0.75% | 4 | $61.9 | 5.58% |
| 4Q 2016 | 1 | -$24.3 | -3.62% | 7 | $38.3 | 5.03% |
| 4Q 2018 | 1 | -$10.8 | 1.69% | 4 | $93.7 | 7.54% |
| 1Q 2020 | 1 | -$21.2 | -0.63% | 7 | $144.8 | 7.49% |
| 1Q 2022 – 4Q 2022 | 4 | -$145.1 | -8.53% | 1 | $4.7 | 2.78% |
| 2Q 2023 – 4Q 2023 | 3 | -$25.7 | 3.53% | – | – | – |
| **Average** | **2.1** | **-$39.2** | **-0.98%** | **5.3** | **$69.6** | **9.09%** |

*This table is for illustrative purposes only and does not reflect the performance of any Franklin Templeton fund. Past performance does not guarantee future results.*

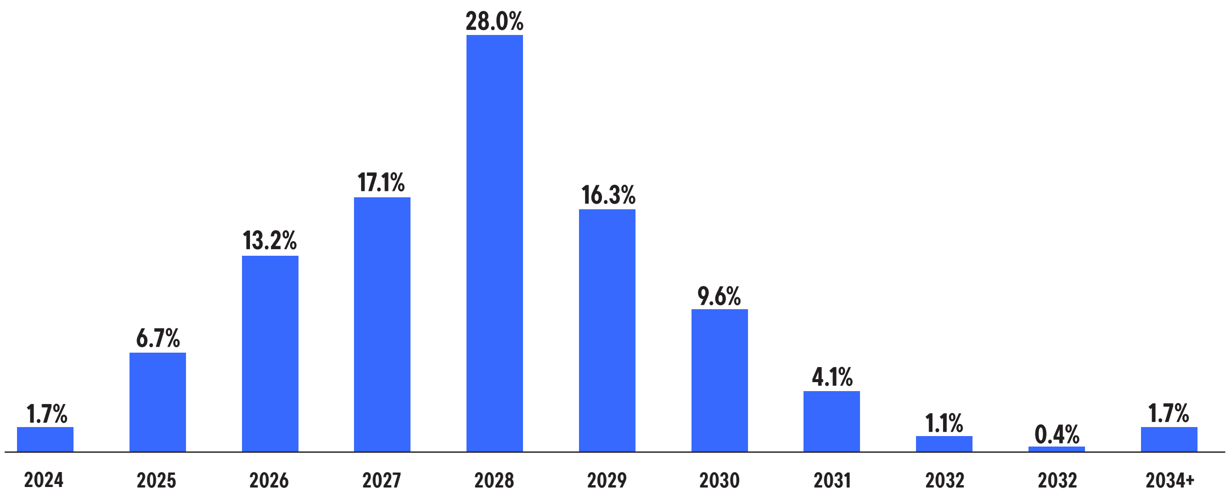
Sources: Franklin Templeton, Bloomberg, ICI. Quarterly inflow/outflow period defined as $1 billion or more.

# 6 | Current markets may warrant a shift into high-yield

## High-yield refinancing risk is relatively low

Many companies with below investment-grade ratings took advantage of the low interest rate environment experienced during the COVID-19 pandemic. Less than 10% of outstanding debt is maturing before the end of 2025, thus most issuers are unlikely to feel the effects of higher rates until 2026 or beyond.

**High-Yield Debt Maturity Schedule (Percent of Total Market Value)**
2024 – 2034




Sources: Intercontinental Exchange, Bank Of America Merrill Lynch Global Research. Represents the amount of high-yield debt maturing as a percent of total outstanding high-yield debt by calendar year for the ICE BofAML US High Yield Index. Maturities shown are from 2024 through 2042. As of December 31, 2023. Due to rounding, figures may not total 100%. Indexes are unmanaged, and one cannot invest directly in an index.

## A reallocation option for uncertain equity markets

Historically, high-yield bonds have performed better than stocks during and immediately after recessions. If a US recession is on the horizon, a reallocation from equities to high-yield bonds may benefit investor portfolios.

**High-Yield Bonds vs. Stocks During and After Recessions**
January 1, 1990 – December 31, 2023


*This chart is for illustrative purposes only and does not reflect the performance of any Franklin Templeton fund. Past performance does not guarantee future results.*

Sources: BrandywineGLOBAL, Morningstar. High-yield bonds and stocks are represented by the ICE BofAML US High Yield Index and the S&P 500 Index, respectively. Only recessions lasting at least six months were considered and include the periods July 1990 to March 1991, March 2001 to November 2001, and December 2007 to June 2009. Indexes are unmanaged and one cannot invest directly in an index.

## Seize the opportunity with Franklin Templeton – A fixed income leader

In 2022, more than a decade of low yields ended abruptly. High inflation and a reactionary Federal Reserve acted to rapidly lift interest rates. Today, higher fixed income yields provide investors with a unique opportunity to generate attractive income, improve long-term total return potential and add diversification to their portfolios.

Franklin Templeton's fixed income specialist investment managers offer a full range of investment strategies and solutions to match investors' long-term goals, objectives and risk tolerance.

Western Asset

**$305 billion[1]**
under management

**Franklin Templeton Fixed Income**

**$184 billion[2]**
under management

Brandywine GLOBAL

**$52 billion[3]**
under management

**Templeton Global Macro**

**$19 billion**
under management

### Fixed income capabilities

- Bank loans
- Credit
- Emerging markets
- Government
- Green/Social bonds
- Multi-sector
- Municipal
- Securitized

Source: Franklin Templeton Investments. Asset under management (AUM) in USD as of November 30, 2023.

1. Excludes $53 billion of cash management, liquid alternatives, and other strategies.
2. Restated to include AUM from Putnam Investments as of November 30, 2023. Franklin Templeton acquired Putnam Investments on January 2, 2024. The AUM also includes a portion of Fiduciary Trust and Benefit Street Partners AUM.
3. Excludes $12 billion of other asset classes.

Brandywine Global Investment Management, LLC and Western Asset Management, LLC are Franklin Templeton companies.

“Compound interest is the eighth wonder of the world. Those who understand it, earn it and those who don’t, pay it.”

Albert Einstein

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