

Franklin U.S. Core Bond ETF

FLCB

Commentary | as of March 31, 2026

Key Takeaways

- **Markets:** The war in the Middle East, which began in late February when the United States and Israel struck Iran, dominated much of the news flow and financial market sentiment over the remainder of the quarter. The reaction in markets has evolved, initially seeing a traditional risk-off move in both the US dollar and US bonds, which then turned into a stagflationary-focused sell-off in core developed bond markets as oil prices surged (although the dollar remained well-supported). The US Federal Reserve remained on hold throughout the quarter. The March FOMC meeting statement and press conference emphasized uncertainty related to the Iran war, indicating that the Fed would look through any initial oil supply shock effect on inflation to focus on core developments, while also noting a likely dragging effect on the economy; ultimately the Committee retained an easing bias. The benchmark 10-year UST yield increased 15 bps to end the quarter at 4.32% (after having fallen to 3.94% in the immediate reaction to the start of the conflict). Fixed income volatility measures rose during the quarter, with much of the increase coming in the wake of the onset of the war in the Middle East. Credit spreads rose over the quarter, with the increase significantly more pronounced in the high-yield sector; total returns in corporate bonds were negative over the quarter. Securitized sectors generated a positive excess return versus duration-matched Treasuries.
- **Contributors:** Yield curve positioning. Security selection in investment-grade (IG) corporate bonds and agency mortgage-backed securities (MBS).
- **Detractors:** Overweight allocation to IG corporate bonds.
- **Outlook:** Looking ahead into 2026, we have favorable view towards the US economy, which remains resilient despite rising external pressures. Impending fiscal stimulus and an intact AI-driven capital expenditure cycle could offset consumption drags. While our 3.0% GDP growth forecast faces downside risks, structural expansion continues, making slower growth far more likely than a recession. Meanwhile, we expect the Federal Reserve to hold rates steady to combat any persistent inflation risks.

Fund Characteristics

Fund Characteristics	Fund
Distribution Frequency	Monthly
30-Day SEC Yield (Fund)—With Waiver	4.22%
30-Day SEC Yield (Fund)—Without Waiver	4.22%

Performance Review

- **Sector allocation modestly detracted from returns**, as the negative impact from an overweight allocation to IG corporate bonds was offset by positive contributions from an overweight position in MBS and a lack of exposure to sovereign emerging markets bonds.
- **Security selection contributed to results during the quarter**, mainly due to selection in IG corporate bonds and MBS.
- **Yield curve positioning supported performance** over the quarter.

Outlook

- US growth has remained surprisingly resilient despite a steady stream of bearish narratives. While rising energy costs tied to escalating Middle East tensions, if sustained, will likely squeeze consumption, the impending fiscal stimulus should offset part of the drag. Meanwhile, the artificial intelligence (AI)-driven capital expenditure (capex) cycle remains intact. Our above-consensus forecast of 3.0% for 2026 US gross domestic product (GDP) growth now faces some downside risk. While recession risk is no longer negligible, it remains a tail risk. The more likely outcome is slower growth, not contraction, with the structural expansion still intact. We expect Federal Reserve (Fed) to remain on hold through the end of Chair Jerome Powell's term and potentially through the year given rising upside risks to inflation. Should inflation broaden beyond energy and become persistent, the Fed could be forced to keep rates higher for longer or even consider renewed tightening.
- While the 2026 Federal Open Market Committee dot plot distribution has narrowed and some participants have shifted their projections higher, the maintenance of unchanged medians suggests a relatively low bar for renewed easing. We feel that as long as growth remains resilient and the expansion continues in line with our expectations, the Fed will remain on pause at least through the end of Powell's term in May 2026, despite their signals of a potential cut. That said, any signs of labor market weakness or evidence that the supply-driven oil price shock is spilling over into core inflation or inflation expectations could force a policy reaction under Powell or his successor. If our views on growth and inflation prove correct and the Fed cuts fewer times than currently priced, we believe U.S. Treasury yields should drift higher, though somewhat favorable demand-supply technicals may limit the extent of this move.
- IG corporate bond spreads widened recently due to geopolitical tensions and rising energy prices, reaching their widest levels since May 2025. However, spreads remain broadly contained as investor demand for attractive all-in yields and consistent inflows continue to provide strong technical support. Corporate fundamentals generally remain supportive, with most IG-rated issuers maintaining the balance sheet flexibility to manage through shifting economic conditions. Nevertheless, macroeconomic crosscurrents and technological disruptions are creating notable dispersion across the market. Looking ahead, new-issue supply is projected to reach record-breaking levels in 2026, acting as a multi-year technical headwind driven heavily by AI-related infrastructure and capital expenditures. While valuations have adjusted modestly, the market continues to price in a sanguine outlook with minimal room for error, favoring a balanced risk posture with a bias toward non-cyclical sectors.
- With mortgage rates remaining in excess of 6%, prepayment risk stays near historically low levels, as less than 9% of the universe possesses an incentive to refinance. While prepayments have increased marginally this year, they remain subdued at an 8.4% constant prepayment rate, and portfolio runoff is expected to stay well below the Federal Reserve's \$35 billion monthly cap. The outlook on Agency MBS is neutral to cautiously constructive in the near term, supported by strong mortgage credit quality and the backstop provided by anticipated GSE purchase programs. However, risks remain, particularly if money managers reduce overweights or if expected bank participation fails to materialize. Value remains present in bonds backed by moderately seasoned, higher-coupon Ginnie Mae collateral, which offer attractive spread

premiums even if rates recede. In the commercial real estate sector, strong investor demand has led to a deterioration in underwriting standards, particularly in conduit deals, where a growing percentage of weaker-tier assets are being included. Consequently, generic spreads do not currently reflect underlying risks, namely higher rates and the potential for further labor market deterioration. Despite these headwinds, specific opportunities remain attractive in extension bonds given their shorter spread duration, natural liquidity from payoffs, and lower beta to macroeconomic and corporate credit spreads. Furthermore, CMBS interest-only bonds can mitigate refinancing difficulties, supporting a constructive approach to current positioning.

Average annual total returns and fund expenses (%) - as of March 31, 2026

Product	Ticker	Listed Exchange	3-Mo*	6-Mo*	YTD*	1-Yr	3-Yr	5-Yr	10-Yr	Inception	Gross Expenses	Net Expenses	Inception Date
Market Price Return	FLCB	NYSE Arca	0.03	1.02	0.03	4.23	3.66	0.16	—	0.93	0.15	0.15	9/17/2019
NAV Returns	—	—	0.07	1.06	0.07	4.33	3.66	0.19	—	0.93	0.15	0.15	9/17/2019
Benchmark	—	—	-0.05	1.05	-0.05	4.35	3.63	0.31	—	0.98	—	—	—

*Cumulative total returns

Benchmark(s)

Benchmark = Bloomberg U.S. 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. An investor cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expense or sales charges. Returns for periods of less than one year are not annualized. For current month-end performance, please visit franklintempleton.com. Net Asset Value (NAV) returns are based on the NAV of the ETF; Market Price returns are based upon the official closing price of the ETF's shares. Returns are average annualized total returns, except for those periods of less than one year, which are cumulative. Market Price returns are calculated using the closing price as of 4 p.m. Eastern time on each trading day (when NAV is normally determined for most funds), and do not represent the returns you would receive if you traded shares at other times. Performance for the ETF and its benchmark index are as of the ETF's last trading day before the end of the period. Since shares of the Fund did not trade in the secondary market until after the Fund's inception, for the period from inception to the first day of secondary trading September 19, 2019, the NAV of the Fund is used as a proxy for the Market Price to calculate market returns. The total annual operating expenses are as of the fund's prospectus available at the time of publication. Actual expenses may be higher and may impact portfolio returns.

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. 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

Capital Expenditure (capex) are funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment.

Duration is a measure of the sensitivity of a bond's price to changes in interest rates.

Gross domestic product (GDP) is the market value of all final goods and services produced within a country in a given period of time.

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.

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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.

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.