Franklin U.S. Core Bond ETF

FLCB | **Commentary | as of December 31, 2025**

Key Takeaways

- **Markets**: The fourth quarter of 2025 (Q4) saw monthly shifts in market sentiment as uncertainties increased in the first part of the quarter. The US federal government went into a shutdown on 1 October as the US Senate was unable to pass a spending bill. This, among other things, delayed or cancelled the publication of key economic data, leading to a lack of clarity on the economic condition of the United States. The shutdown was lifted mid-November, and subsequent data showed that economic growth in the United States remained resilient. The US Federal Reserve (Fed) delivered three consecutive 25-basis-point (bp) cuts in Q4, helping market sentiment to improve in December. Fixed income volatility measures fell towards the end of the quarter, reaching their lowest level since 2021. Securitized sectors saw positive absolute and excess returns, as did lower-quality corporate credit, as spreads tightened. Investment-grade corporate bonds had positive absolute returns but failed to keep pace with their duration-matched US Treasuries (USTs). The US yield curve steepened as shorter-maturity yields fell while longer-dated bond yields rose. The benchmark 10-year UST yield increased two bps to end the quarter at 4.17%.
- **Contributors**:. Overweight agency mortgage-backed securities (MBS). Security selection in investment-grade (IG) corporate bonds.
- **Detractors**:. Yield curve positioning.
- **Outlook**:. Looking ahead into 2026, we have a favorable view towards the US economy and are looking for strong growth in the first half of the year. In our view, intermediate- and longer-term UST yields remain too low, but can likely remain here until the Fed finishes their rate-cutting cycle. Fixed income spreads remain tight on a historical basis, but they still provide opportunities when looked at an income and yield prospective.

Fund Characteristics	Fund
Distribution Frequency	Monthly
30-Day SEC Yield (Fund)—With Waiver	4.08%
30-Day SEC Yield (Fund)—Without Waiver	4.08%

Performance Review

- **Sector allocations contributed to returns** led by overweight exposure to MBS.
- **Security selection detracted from results** as selection in MBS hurt returns. In contrast, selection in IG corporate bonds helped performance for the quarter.
- **Yield curve positioning detracted from performance** over the quarter.

Outlook

- Progress on disinflation has stalled since April. Tariffs have pushed core goods prices higher, while core services excluding housing ("supercore") have reaccelerated above 3%. In 2026, we think inflation risks should be balanced, with the potential for upside surprises. Strong growth in the first half of the year and a more stable labor market can keep supercore sticky. On goods, much of the tariff effect is still ahead. Although the trade-weighted applied tariff rate is roughly 16%, effective, tariffs paid were under 11% as of July, explaining the muted goods price pass-through. We expect effective rates to rise in the coming months. While applied and effective tariff rates could fall if the Supreme Court rules against the administration on tariffs applied under the International Emergency Economic Powers Act (IEEPA), we think the White House will reimpose similar tariffs via Sections 122 and 301. That said, a partial recreation of IEEPA could limit upside risks to goods prices. Overall, gradual rent moderation combined with persistent services inflation should keep core personal consumption expenditures well above the Fed's 2% target through 2026.
- On interest rates, although the Fed has signaled one more cut for 2026, we continue to believe that the Fed will remain on pause at least through Fed Chair Jerome Powell's term ending in May 2026, and potentially through 2026 (as long as growth remains resilient and the expansion continues in line with our expectations). That said, the Fed's reaction function does lean dovish, and any signs of labor market weakness could force additional "risk-management" cuts under Powell or his successor. If our growth and inflation views are right and the Fed cuts fewer times than priced, we believe UST yields should drift higher from here. However, somewhat favorable demand-supply technicals (slower issuance of long-term USTs and the return of price-insensitive investors) could potentially limit how high yields might go in 2026.
- IG corporate bond spreads moved modestly tighter over the quarter, as investor demand for attractive yields remained robust, with worries of the impact of US trade policies and Fed inaction decreasing. Credit spreads are still inside longer-term averages and remain close to their tightest levels in the past 25 years. In corporate credit markets, UST yield moves and demand technicals are likely to continue to have a material impact on credit spreads and asset class returns moving forward. IG credit spreads are still trading on all-in yield compensation rather than on credit spreads. Corporate fundamentals generally remain supportive, with many IG-rated issuers having the flexibility and cushion to deal with changing economic conditions. However, evolving tariff policy and increasing mergers and acquisitions (M&A) will impact sectors differently, creating dispersion. Fundamentals have remained resilient as well amid broader policy uncertainty, while valuations continue to be squeezed. New-issue supply is projected to be heavy in 2026 as M&A activity and AI-related issuance should drive a surplus. We have a neutral outlook on IG corporate bonds as the asset classes provide additional yield, but we feel spreads are more likely to widen than tighten over the medium term.
- With mortgage interest rates remaining above 6%, we still feel that prepayment speeds will remain low for seasoned collateral, since borrowers are unlikely to walk away from properties with extremely low interest rates. In contrast, those borrowers that have more recently issued mortgages do face some risks of refinancing as rates remain high. With strong built-in equity levels and a supportive economic backdrop, involuntary prepayments should remain subdued over the medium term. We have a neutral outlook on agency mortgage-backed securities (MBS) over the medium term, with a neutral fundamental and favorable technical outlook for the sector. Although historically high money manager overweight is a potential hurdle for spread tightening, we anticipate increased demand from banks if the yield curve normalizes or regulatory uncertainty dissipates. Although China, Canada and Japan's agency bond holdings continued to decline, potential dollar

weakness could attract buyers as currency hedge-adjusted yields become more attractive. We see the CMBS credit curve as being too flat, but we also see CMBS as offering good opportunities for security selection when utilizing detailed loan-level analysis, particularly when considering relative value to other sectors. Specific opportunities remain attractive in extension bonds given their shorter spread duration, natural liquidity from payoffs and and lower beta to macro and IG corporate credit spreads. Furthermore, CMBS interest-only bonds can provide protection against refinancing difficulties/inabilities. As such, we remain constructive on our current positioning.

Average annual total returns and fund expenses (%) - as of December 31, 2025

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	0.99	3.02	6.97	6.97	4.73	-0.49	—	0.96	0.15	0.15	9/17/2019
NAV Returns	—	—	0.99	3.02	7.08	7.08	4.73	-0.49	—	0.96	0.15	0.15	9/17/2019
Benchmark	—	—	1.10	3.15	7.30	7.30	4.66	-0.36	—	1.03	—	—	—

*Cumulative total returns

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. 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

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

Personal consumption expenditures, or PCE, is a measure of price changes in consumer goods and services.

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.

ETFs and ETPs trade like stocks, fluctuate in market value and may trade at prices above or below the ETFs/ETPs net asset value. Brokerage commissions and ETF expenses will reduce returns. ETF/ETP shares may be bought or sold throughout the day at their market price, not their Net Asset Value (NAV), on the exchange on which they are listed. Shares of ETFs/ETPs are tradable on secondary markets and may trade either at a premium or a discount to their NAV on the secondary market. **Canada:** This content is intended only for Canadian institutional investors that qualify as "permitted clients" as defined in National Instrument 31-103 - Registration Requirements, Exemptions and Ongoing Registrant Obligations. U.S. securities laws generally limit a non-U.S. fund's purchase of a U.S. registered mutual fund or ETF/ETP (a "U.S. Fund") to no more than 3% of the U.S. Fund's voting stock. You should consult your legal counsel prior to investing in a U.S. Fund.

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.