

Franklin U.S. Core Bond ETF

Commentary | as of June 30, 2025

Key Takeaways

- **Markets:** There were large swings in financial market sentiment across the second quarter of 2025. Fixed income spreads generally widened in April amid US President Donald Trump's "Liberation Day" tariff announcements. A subsequent 90-day pause for most of the increased levies and the passage of the "One Big Beautiful Bill" spending package after quarter-end helped reduce fixed income market uncertainties.
- **Contributors:** Overweight investment-grade (IG) corporate bonds. Security selection in agency mortgage-backed securities (MBS). Overall duration positioning.
- **Detractors:** Allocations to sovereign developed and emerging market debt. Security selection in IG corporate bonds.
- **Outlook:** In our view, the US Federal Reserve (Fed) is unlikely to cut interest rates soon. Despite recent signs of cooling inflation, Fed officials remain cautious due to ongoing tariff-related uncertainties. We expect longer-term rates to continue to climb higher through the rest of the year.

Performance Review

- Our overweight to IG corporate bonds contributed to relative performance, whereas security selection in the sector hindered results.
- Security selection in MBS was a contributor. Conversely, allocations to sovereign developed and emerging market debt detracted from performance.
- Overall duration positioning was positive for returns. Performance gains from exposures to the 10- and 30-year portions of the curve were slightly offset by negative results from exposure to the 20-year portion of the curve.

Outlook

- In our view, the Fed is unlikely to cut interest rates soon. Despite recent signs of cooling inflation, Fed officials remain cautious due to ongoing tariff-related uncertainties. Companies are expected to raise prices as pre-tariff inventories diminish, leading to a likely rise in core goods inflation. Furthermore, average US tariff rates remain historically high despite a temporary easing in US-China trade tensions. We therefore expect potentially higher inflation and slower growth. With inflation still above target and risks skewed to the upside, we expect the Fed to maintain its pause. Amid still-resilient industrial production and retail sales, we believe the Fed is likely to stay on hold until there is clear evidence of labor market deterioration without a simultaneous rise in inflation.
- The "One Big Beautiful Bill" spending package will further increase the US deficit over the next decade. Combined with factors such as uncertain trade policy (which has raised stagflationary concerns) and an expansionary fiscal policy (which implies greater debt issuance), we expect longer-term rates to continue to climb higher through the rest of the year.
- For the corporate credit sectors, we maintain our emphasis on diligent security selection and individual company fundamentals. IG credit fundamentals have remained supportive. While we believe IG corporate bonds continue to offer relatively attractive yield, spread levels offer little cushion for further economic, market or geopolitical surprises. In our view, spreads will likely remain in a trading range but, at current levels, are more likely to widen than tighten. In the lower-credit-quality high-yield and floating-rate bank loan sectors, although we remain broadly constructive amid generally supportive technical conditions, we continue to favor quality companies amid persistent market bifurcation and idiosyncratic opportunities as we evaluate each company's fundamentals and exposure to different possible policy alternatives.
- For securitized sectors, our generally neutral stance remains largely unchanged. Prepayment risk remains minimal, and mortgage credit quality remains high. The fundamental and technical outlook for the sector remains favorable, with attractive relative value to IG corporates. We also anticipate increased demand from banks if the yield curve normalizes or regulatory uncertainty dissipates. For residential mortgage-backed securities, heightened macroeconomic uncertainty due to the Trump administration's fiscal and foreign policies and tense geopolitical climate could result in more periods of elevated rate volatility and "risk-off" episodes. We therefore prefer a defensive positioning at the top of capital stack in higher carry profile bonds with limited extension risk. Despite our generally cautious stance, we are finding value and identifying opportunities in higher-quality fixed income investments.

Fund Characteristics

	Fund
Distribution Frequency	Monthly
Effective Duration	6.05 Years
30-Day SEC Yield (Fund)—With Waiver	4.44%
30-Day SEC Yield (Fund)—Without Waiver	4.44%

Sector Exposure (% of Total)

Sector	Fund
U.S. Treasuries	40.01
Investment Grade Corporates	29.00
Agency Mortgage-Backed Securities	27.54
Interest Rate Derivatives	7.08
Commercial Mortgage Backed Securities	1.67
Municipal Bonds	0.68
U.S. Agency	0.12
Non-US Developed Bonds	0.02
Cash & Cash Equivalents	0.89

Credit Quality Exposure (% of Total)

Rating	Fund
AAA	1.15
AA	68.67
A	9.53
BBB	19.63
NR	0.07
Not Applicable	0.06
Cash & Cash Equivalents	0.89

Average annual total returns and fund expenses (%) - as of June 30, 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	1.15	3.84	3.84	6.07	2.65	-0.72	—	0.53	0.15	0.15	9/17/2019
NAV Returns	—	—	1.20	3.94	3.94	6.02	2.66	-0.70	—	0.52	0.15	0.15	9/17/2019
Benchmark	—	—	1.21	4.02	4.02	6.08	2.55	-0.73	—	0.58	—	—	—

*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

Residential mortgage-backed securities (RMBS) are a type of mortgage-backed debt obligation created from residential debt, such as mortgages, home-equity loans and subprime mortgages. **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. **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. **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. 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. **Credit Quality** is a measure of a bond issuer's ability to repay interest and principal in a timely manner. The credit ratings shown are based on each portfolio security's rating as provided by Standard and Poor's, Moody's Investors Service and/or Fitch Ratings, Ltd. and typically range from AAA (highest) to D (lowest), or an equivalent and/or similar rating. For this purpose, the manager assigns each security the middle rating from these three agencies. When only two agencies provide ratings, the lower of the two ratings will be assigned. When only one agency assigns a rating, that rating will be used. Foreign government bonds without a specific rating are assigned a country rating, if available. Securities that are unrated by all three agencies are reflected as such. The credit quality of the investments in the Fund's portfolio does not apply to the stability or safety of the Fund. These ratings are updated monthly and may change over time. **Please note, the Fund itself has not been rated by an independent rating agency.**

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