

Franklin Equity Income SMA

Commentary | as of December 31, 2025

Key Takeaways

- Markets:** US equities delivered solid gains over the fourth quarter of 2025, maintaining their upward trajectory against a backdrop of generally robust corporate earnings, despite some mixed economic signals and investor concerns about stretched valuations in technology-related stocks. Continued monetary easing by the US Federal Reserve, along with a constructive shift in US-China relations, also underpinned investor sentiment. The outperformance of the Magnificent Seven mega-capitalization technology stocks during the quarter boosted returns for the S&P 500 Index and the Nasdaq Composite Index, while the relatively strong performance of the Dow Jones Industrial Average reflected the enduring strength of blue-chip companies. By investment style, value investing surpassed growth in the large-, mid- and small-capitalization tiers, with large-cap stocks performing better than their mid- and small-cap counterparts.
- Contributors:** The strategy (pure gross of fees and net of fees) delivered positive returns that trailed the Russell 1000 Value Index. In absolute terms, the health care and financials sectors were key drivers of positive returns. In the health care sector, the pharmaceuticals industry held two of the strategy's top contributors, while the capital markets and banking industries had a positive impact on the financials sector.
- Detractors:** The consumer discretionary, materials and utilities sectors detracted most from absolute returns. The consumer discretionary sector was pressured by performance in the specialty retail and household durables industries. In the materials sector, our focus on the chemicals industry proved adverse and investments in the electric utilities industry dampened results in the utilities sector.
- Outlook:** We have had a positive view of the outlook for corporate earnings and the equity market overall given the likelihood of lower regulation aiding several industries, favorable tax policy and ongoing productivity gains from technology. Inflation is within reasonable levels, and we believe interest rates are likely to move at least moderately lower by year-end 2026. We continue to believe that overall macro conditions could support broad market participation across industries. That remains our "base case" for 2026—similar to last year. While the information technology (IT) sector has driven most of the market gains for the past few years, we believe that opportunities within the industrials, health care, financials and utilities sectors have the potential to do well in 2026.

Performance Review

- Morgan Stanley delivered strong stock performance in the financials sector. The global financial services company posted robust earnings in the third quarter of 2025, driven by growth in its institutional and wealth management businesses.
- The health care sector benefited from a position in Johnson & Johnson (JNJ). The pharmaceutical giant's stock performed well, mainly due to strong third-quarter 2025 earnings results and raised full-year sales guidance, along with positive trial results and US Food & Drug Administration-approved label expansions for several of its products. We continue to see JNJ as a company with a highly resilient business model and leadership in the medical technology industry.
- In contrast, investor concerns about company debt and aggressive artificial intelligence infrastructure expansion weighed on shares of software giant Oracle in the IT sector.

Outlook

- We continue to look for opportunities where we believe realized earnings by many companies can be more resilient or may have the potential to grow faster than consensus, and where long-term market leadership seems underappreciated by some investors. Today's environment presents some uncertainty; however, we believe themes around IT productivity, infrastructure (broadly speaking) and asset management could prove to be particularly attractive and durable.
- We have had a positive view of the outlook for corporate earnings and the equity market overall given the likelihood of lower regulations aiding several industries, favorable tax policy and ongoing productivity gains from technology. We believe this can support broader market participation across industries.
- Despite the positive backdrop that we see, some companies may report mixed earnings results in the fourth quarter due to uneven tariff headwinds. In our view, companies have largely navigated uncertainty well, with robust companies benefiting from secular themes performing strongly. If correct, we believe our efforts to find these high-quality companies can have beneficial outcomes over time.
- We believe the portfolio can hold up relatively well during periods of higher volatility, given our focus on quality and the use of lower-beta equity-linked notes and convertible securities. Powerful secular themes seen throughout the portfolio, like infrastructure improvement, energy transition and "grid hardening," can continue to be positive areas of investment as those themes play out over time, in our view.

Top Equity Issuers (% of Total)

Holding	Portfolio
JPMORGAN CHASE & CO	4.59
MORGAN STANLEY	3.37
BANK OF AMERICA CORP	3.20
CHEVRON CORP	2.74
JOHNSON & JOHNSON	2.74
ALPHABET INC	2.51
CHARLES SCHWAB CORP/THE	2.30
PARKER-HANNIFIN CORP	2.20
AMERICAN EXPRESS CO	2.13
PROCTER & GAMBLE CO/THE	2.04

Average annual total returns (%) - as of December 31, 2025-PRELIMINARY

Composite	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	2.20	9.17	14.50	14.50	12.31	9.78	—	—	—	—	15.18	3/31/2020
Pure Gross of Fees	2.95	10.77	17.89	17.89	15.65	13.05	—	—	—	—	18.59	3/31/2020
Benchmark	3.81	9.34	15.91	15.91	13.90	11.33	—	—	—	—	16.44	—

*Cumulative total returns

Benchmark(s)

Benchmark =Russell 1000 Value Index

The strategy returns shown are preliminary composite returns, subject to future revision (downward or upward).

Past performance is not a guarantee of future results. An investment in this strategy can lose value. Please visit www.franklintempleton.com for the latest performance figures. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

Fees: Periods less than one year are not annualized. Performance results are for the composite which includes all actual, fully discretionary accounts with substantially similar investment policies and objectives managed to the composite's investment strategy. Composite returns are stated in U.S. dollars and assume reinvestment of any dividends, interest income, capital gains, or other earnings. The composite may include account(s) that are gross of fees and pure gross of fees. "Pure" gross-of-fee returns do not reflect the deduction of any expenses, including transaction costs. A traditional (or "true") gross-of-fee return reflects performance after the reduction of transaction costs but before the reduction of the investment advisory fee. The gross-of-fee return may include a blend of "true" gross-of-fee returns for non-wrap accounts and "pure" gross-of-fee returns for wrap accounts. Net-of-fee returns is reduced by a model "wrap fee" (3.0% is the maximum anticipated wrap fee for equity and balanced portfolios) which includes trading expenses as well as investment management, administrative and custodial fees. The model wrap fee used represents the highest anticipated wrap fee applicable to the strategy. Actual fees and account minimums may vary.

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All investments involve risks, including possible loss of principal. To the extent the portfolio invests in a **concentration of certain securities, regions or industries**, it is subject to increased volatility. **Equity securities** are subject to price fluctuation and possible loss of principal. **Distributions** are not guaranteed and are subject to change. **Active management** does not ensure gains or protect against market declines. **International investments** are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in **emerging markets**. 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.

Glossary

Convertible securities are bonds or preferred stocks that can be converted into a preset number of shares of common stocks after a predetermined date.

Dow Jones Industrial Average (DJIA) is an unmanaged index composed of 30 blue-chip stocks, each with annual sales exceeding \$7 billion. The DJIA is price-weighted, reflects large-cap companies representative of U.S. industry, and historically has moved in tandem with other major market indexes such as the S&P 500. Source: © S&P Dow Jones Indices LLC.

The **Magnificent Seven** stocks are Apple, Amazon, Alphabet, Meta Platforms, Microsoft, Nvidia, and Tesla.

Nasdaq Composite Index is a market-capitalization-weighted index that is designed to represent the performance of Nasdaq securities and includes over 3,000 stocks. Source: Nasdaq OMX.

The **S&P 500 Index** features 500 leading U.S. publicly traded companies, with a primary emphasis on market capitalization. Source: © S&P Dow Jones Indices LLC. All rights reserved.

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The **Russell 1000 Value Index** measures the performance of the large-cap value segment of the U.S. equity universe.

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Source: FTSE.

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