

Franklin U.S. Government Ladder 5-20 Year SMA

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 selloff in core developed bond markets as oil prices surged (although the dollar remained well-supported). The US Federal Reserve (Fed) remained on hold throughout the quarter. The March Federal Open Market Committee (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. Over the period, the US Treasury (UST) yields moved higher across the curve over the three-month period, resulting in a broader upward shift in the interest rate environment. Yields climbed by 32 basis points (bps) to 3.79% on the two-year UST note, and by 22 bps to 3.94% on the five-year UST note. By the end of the period, the yield on the benchmark 10-year UST note had risen by 15 bps to 4.32%, while the yield on the 30-year UST bond stood seven bps higher at 4.91%.
- **Contributors:** Underweight exposure to the 20-year portion of the UST yield curve.
- **Detractors:** Overweight exposure to the 10-year portion of the UST yield curve. Out-of-index exposure to US government agency bonds.
- **Outlook:** Looking ahead into 2026, we have a favorable view toward the US economy, which remains resilient despite rising external pressures. Impending fiscal stimulus and an intact artificial intelligence (AI)-driven capital expenditure cycle could offset consumption drags. While our gross domestic product (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.

Performance Review

- Yield curve positioning supported returns, driven primarily by an underweight exposure to the 20-year portion of the curve as yields rose across the board. In contrast, an overweight allocation to the 10-year segment detracted from performance. Our out-of-index holdings of US government agency bonds curbed relative results.

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 throughout 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 FOMC 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.

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

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	-0.48	-0.25	-0.48	1.45	0.49	-2.38	—	—	—	—	-3.63	6/30/2020
Pure Gross of Fees	-0.11	0.50	-0.11	2.97	2.00	-0.91	—	—	—	—	-2.18	6/30/2020
Benchmark	-0.43	0.27	-0.43	2.34	1.03	-2.10	—	—	—	—	-3.87	—

*Cumulative total returns

Benchmark(s)

Benchmark = Custom 33% Bloomberg 5-10 Year Treasury Index + 67% Bloomberg 10-20 Year Treasury Index

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Glossary

A **basis point (bp, or bps)** is one one-hundredth of one percent (1/100% or 0.01%).

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

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.

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The **Bloomberg 5-10 Year Treasury Index** measures the performance of public obligations of the U.S. Treasury with maturities of 5-10 years. The **Bloomberg 10-20 Year Treasury Index** measures the performance of public obligations of the U.S. Treasury with maturities of 10-20 years. Source: Bloomberg Indices.

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