

Franklin U.S. Government Ladder 1-5 Year SMA

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 October 1 as the US Senate was unable to pass a spending bill. This, among other things, delayed or canceled 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. US trade policy continued to be a source of uncertainty. The US Federal Reserve (Fed) delivered three consecutive 25-basis point cuts in Q4, helping market sentiment to improve in December. Fixed income volatility measures fell toward the end of the quarter, reaching their lowest level since 2021. Over the period, the US Treasury (UST) yield curve steepened as shorter-maturity yields fell while longer-dated bond yields rose. The one-month UST bill fell 51 bps, and three-month UST bill yields declined 31 bps. Yields moved lower by 14 bps to 3.47% on the two-year UST note and by two bps to 3.73% on the five-year UST note.
- **Detractors:** Underweight overall duration.
- **Outlook:** We believe inflation risks should be balanced with potential upside surprises in 2026, with core personal consumption expenditures remaining above the Fed's 2% target. Although the Fed signaled one cut for 2026, we anticipate a pause through Fed Chair Jerome Powell's term ending in May 2026, with labor market weakness being a key trigger for any "risk-management" cuts. If the Fed cuts fewer times than priced, we believe UST yields will drift higher. However, demand-supply technicals may limit how high yields climb in 2026.

Performance Review

- Yield curve positioning hurt results as an underweight duration exposure to the two- and five-year portions of the curve detracted from returns as UST yields fell.

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.

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

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	0.73	1.50	4.04	4.04	2.92	0.10	—	—	—	—	0.00	6/30/2020
Pure Gross of Fees	1.10	2.26	5.59	5.59	4.46	1.61	—	—	—	—	1.50	6/30/2020
Benchmark	1.15	2.30	5.84	5.84	4.50	1.28	—	—	—	—	1.19	—

*Cumulative total returns

Benchmark(s)

Benchmark =Bloomberg 1-5 Year Treasury Index

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" (1.5% is the maximum anticipated wrap fee for fixed income 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. For fee schedules, contact your financial professional, or if you enter into an agreement directly with Franklin Templeton Private Portfolio Group, LLC ("FTPPG"), refer to FTPPG's Form ADV Part 2A disclosure document. Management and performance of individual accounts may vary for reasons that include the existence of different implementation practices and model requirements in different investment programs.

Franklin Templeton claims compliance with the Global Investment Performance Standards (GIPS®). GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

To obtain specific information on available products and services or a GIPS Report, contact your Franklin Templeton separately managed account sales team at (800) DIAL BEN/342-5236.

What are the Risks?

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. **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. **Liquidity risk** exists when securities or other investments become more difficult to sell, or are unable to be sold, at the price at which they have been valued. **Active management** does not ensure gains or protect against market declines. The portfolio is **non-diversified** and may invest in a relatively small number of issuers, which may negatively impact the performance and result in greater fluctuation in 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.

Glossary

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

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 portfolio. 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 portfolio's selection process. Holdings are subject to change.

These materials are being provided for illustrative and informational purposes only. The information contained herein is obtained from multiple sources that are believed to be reliable. However, such information has not been verified, and may be different from the information included in documents and materials created by the sponsor firm in whose investment program a client participates. Some sponsor firms may require that these materials be preceded or accompanied by investment profiles or other documents or materials prepared by such sponsor firms, which will be provided upon a client's request. For additional information, documents and/or materials, please speak to your Financial Professional or contact your sponsor firm.

Franklin Templeton (FT) is not undertaking to provide impartial advice. Nothing herein is intended to provide fiduciary advice. FT has a financial interest.

The **Bloomberg 1-5 Year Treasury Index** measures the performance of public obligations of the U.S. Treasury with maturities of 1-5 years. Source: Bloomberg Indices.

Important data provider notices and terms available at www.franklintempletondatasources.com. All data is subject to change.

Separately Managed Accounts (SMAs) are investment services provided by Franklin Templeton Private Portfolio Group, LLC (FTPPG), a federally registered investment advisor. Client portfolios are managed based on investment instructions or advice provided by affiliated subadvisors of Franklin Templeton. Management is implemented by FTPPG, the designated subadvisor or, in the case of certain programs, the program sponsor or its designee.

© Franklin Templeton. All rights reserved.