FRANKLIN TEMPLETON

Franklin Intermediate Fixed Income SMA

Commentary | as of June 30, 2025

Key Takeaways

- **Markets:** There were large swings in market sentiment across the second quarter of 2025 (Q2). In early April, United States (US) President Donald Trump's announced significant increases in US tariff rates as part of his "Liberation Day". Spreads across fixed income sectors widened as fears that they could lead to a drop in growth and a new round of inflationary pressures, which could damage the US economy. Subsequently, a temporary pause (in many cases 90 days) in increased levies helped calm some of the market nerves. The passage of the "One Big Beautiful Bill" spending package further helped reduce the uncertainties that had been a strong headwind to fixed income markets. For the quarter, both absolute and excess returns were widespread across fixed income sectors, in particular corporate credit. US Treasury (UST) yield changes were mixed with shorter- and intermediate-term yields falling, while longer-maturity yields rose. The benchmark 10-year UST yield rose two basis points (bps) to end the quarter at 4.23%..
- **Contributors:** Security selection in communications and consumer non-cyclicals. Overweight insurance and consumer non-cyclicals. Overweight BBB and A- bonds. Security selection in BBB+ and BBB rated bonds.
- **Detractors:** Security selection in insurance and energy bonds. Lack of exposure to BBB- bonds. Overweight BBB+ rated bonds. Security selection in AA+, A and A- rated bonds.
- **Outlook:** We prefer to stay on the shorter-end of the investment-grade (IG) corporate bonds curve to lessen the capital depreciation in the event of rising credit spreads. We feel that we should preserve dry powder here as valuations remain stretched taking advantage new-issue concession in these sectors.

Performance Review

- Sector allocations had a neutral impact on the strategy's relative performance for the quarter. In contrast, security selection contributed to performance, led by selection in the communications and consumer non-cyclical sectors. This was only partially offset by selection in insurance- and energy-related issues, which curbed relative results.
- Rating allocations helped relative results. Positive return contributions came from an overweight to A- rated bonds. This was partially offset by negative results from our lack of exposure to BBB- and an underweight to BBB+ rated bonds curbed returns as these lower-rated categories tended to outperform their higher-rated counterparts. Security selection within rating classifications was accretive to results, led by selection in BBB+ and BBB bonds. However, selection in AA+, A and A- rated bonds curbed returns.
- Yield curve positioning had a minimal impact of performance for the quarter.

Outlook

- US investment-grade (IG) credit markets generated positive absolute total returns of the second quarter of 2025, generally driven by tighter credit spreads, despite a turbulent start to the quarter following "Liberation Day." While spreads saw volatility to begin 2025, current levels are currently closer to the tights, and well through levels in the last growth and recession scare during 2022.
- Risk assets more broadly faltered in the first month of the quarter but rallied significantly as investors shifted their focus to potential revisions to trade policy and improved macro conditions.
- In corporate credit markets, volatility in UST yields and market technical forces likely continue to have a material impact on credit spreads and asset class returns moving forward, with IG credit spreads increasingly trading more on all-in yield compensation than on credit spreads.
- Corporate fundamentals do remain broadly supportive, with many IG-rated issuers having flexibility and cushion to deal with changing economic conditions. However, uncertainty surrounding policy and tariffs will impact sectors differently. The autos sector, for example, is poised to realize direct impacts from tariff policy that cloud the fundamental picture moving forward for companies in that space, and has seen great volatility in bond prices. Cyclical sectors, such as energy and chemicals, will likely see earnings volatility from demand shocks. Select non-cyclical sectors, such as health care and pharmaceuticals, are likely to see volatility from changing tariff policy.
- Asset class technicals have remained sturdy: All-in yields near 6% in the long end are attractive, in our view, and continue to bolster the technical demand backdrop. Fundamentals have largely remained resilient amid the volatility, while valuation continues to be squeezed
- We prefer to stay on the shorter-end of the curve to lessen the capital depreciation in the event of rising credit spreads. We feel that we should preserve dry powder here as valuations remain stretched taking advantage new-issue concession in these sectors..

Average annual total returns (%) - as of June 30, 2025-PRELIMINARY

Product	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	1.35	3.46	3.46	4.97	2.01	-0.70	0.79	1.17	2.04	2.67	3.16	3/31/1994
Pure Gross of Fees	1.73	4.23	4.23	6.54	3.54	0.79	2.14	2.42	3.26	3.86	4.30	3/31/1994
Benchmark	1.67	4.13	4.13	6.74	3.57	0.64	2.04	2.29	3.02	3.78	4.26	—

*Cumulative total returns

Benchmark(s)

Benchmark =Bloomberg Intermediate U.S. Government/Credit 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.

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Glossary

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

Investment grade is a rating that indicates that a municipal or corporate bond has a relatively low risk of default. BBB is medium credit quality rating.

The **yield curve** shows the relationship between yields and maturity dates for a similar class of bonds.

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The **Bloomberg Intermediate Government/Credit Index** is an unmanaged index that measures the performance of intermediate (one to ten years) government and corporate fixed-rate debt issues. Source: Bloomberg Indices.

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