

# Franklin Intermediate Fixed Income 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) left the fed funds rate unchanged at 3.50% - 3.75% during the first quarter of 2026. Although the combination of hawkish economic forecasts and unchanged median rate projections from the March Federal Open Market Committee (FOMC) meeting implies a low bar for easing later this year, especially if geopolitical risks fade quickly, we expect the Fed to remain on hold through the end of Powell's term and potentially through the end of the year given rising upside risks to inflation. Fixed income volatility measures rose during the quarter, with much of the increase coming in the wake of the onset of the war in the Middle East. The benchmark 10-year US Treasury (UST) yield increased 15 basis points to end the quarter at 4.32% (after having fallen to 3.94% in the immediate reaction to the start of the conflict).
- **Contributors:** Security selection in the insurance and communications sectors, and in AA+, A, A-, BBB+ and BBB rated bonds. Lack of exposure to consumer cyclicals, finance companies, sovereign bonds and BBB- rated bonds. Underweight allocation to BBB+ rated bonds.
- **Detractors:** Security selection in the consumer non-cyclical sector. Overweight allocations to the insurance, communications and consumer non-cyclical sectors, and to A-, BBB and AA+ rated bonds.
- **Outlook:** While spreads widened by quarter-end, we continue to feel that investment-grade (IG) corporate bonds remain attractive on the short end of the yield curve.

## Performance Review

- Security selection within sectors contributed to results, primarily due to selection in UST bonds and in insurance and communications names. This was partially offset by negative return contributions from our selection in the consumer non-cyclical sector. Sector allocation detracted from performance, led by overweights to the insurance, communications and consumer non-cyclical sectors. In contrast, a lack of exposure to consumer cyclicals, finance companies and sovereign bonds supported returns.
- Ratings positioning was another contributor to results. Security selection in AA+, A, A-, BBB+ and BBB rated bonds lifted performance during the quarter, as did a lack of exposure to BBB- rated bonds and an underweight allocation to BBB+ rated issues. In contrast, an overweight allocation to A-, BBB and AA+ rated bonds hurt performance.
- Yield curve positioning contributed to returns due to an underweight to the two-year area of the yield curve.

## Outlook

- IG corporate bond spreads have widened recently due to geopolitical tensions and rising energy prices, reaching their widest levels since May 2025. However, spreads remain broadly contained as investor demand for attractive all-in yields and consistent inflows continue to provide strong technical support. Credit fundamentals generally remain supportive, providing most IG issuers with substantial flexibility to manage through shifting economic and market conditions.
- In our view, IG corporate bonds continue to offer relatively safe yield, spread levels again offer little cushion for further economic, market or geopolitical surprises. Spreads can stay tight and trade in a tight range despite rising releveraging risk from mergers and acquisition activity, financial engineering and outsized artificial intelligence (AI)-related capital expenditure (capex). Asset class technicals have remained resilient—all-in yields remain attractive in our view and keep the technical demand backdrop intact for the relative perceived safety of the asset class. One large concern is the magnitude of new-issue supply, which is projected to be close to \$2 trillion for 2026.
- This leads us to maintain a neutral stance on IG credit while highlighting potential concerns on current valuation levels.

## Average annual total returns (%) - as of March 31, 2026-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	-0.28	0.39	-0.28	2.88	2.55	0.03	0.70	1.14	2.17	2.39	3.13	3/31/1994
Pure Gross of Fees	0.10	1.14	0.10	4.42	4.08	1.53	2.09	2.43	3.41	3.59	4.29	3/31/1994
Benchmark	-0.02	1.17	-0.02	4.41	4.24	1.33	2.04	2.36	3.18	3.49	4.24	—

\*Cumulative total returns

## Benchmark(s)

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

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

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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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Source: Bloomberg Indices.

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