

Franklin Intermediate Investment Grade Credit SMA

Commentary | as of March 31, 2026

Key Takeaways

- **Markets:** From late-February, the war in the Middle East dominated much of the news flow and financial market sentiment. 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 sell-off 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. 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. Credit spreads rose over the quarter, with the increase significantly more pronounced in the high-yield sector; total returns in corporate bonds were negative over the quarter. Securitized sectors generated a positive excess return versus duration-matched Treasuries.
- **Contributors:** Security selection in BBB and BBB+ rated bonds, as well as selection in the consumer cyclical sector.
- **Detractors:** Yield curve positioning. Lack of exposure to supranational bonds.
- **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.

Performance Review

- Security selection by sector lifted relative performance over the period. The positive relative contributions of selection in the consumer cyclical, technology, and insurance sectors were partially offset by the weaker performance of selection in the banking sector. Sector allocations restrained relative performance due, in part, to a lack of exposure to both supranational and local authority bonds, as well as an overweight to insurance securities. In contrast, a lack of exposure to both sovereign and financial company bonds boosted relative performance.
- Security selection in rating categories was beneficial as selection in BBB and BBB+ rated bonds lifted relative returns, along with selection in A+ rated bonds. In contrast, selection in A- rated bonds detracted from performance. Rating allocations held back relative results led by an underweight to AAA rated bonds. In contrast, a lack of exposure to BBB- rated bonds contributed to relative results.
- Overall duration effect was positive, although yield curve positioning detracted over the quarter due, in part, to a slightly underweight position on the 10-year section of the curve.

Outlook

- While the 2026 Federal Open Market Committee 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. 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.

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	-0.41	0.39	-0.41	3.57	3.27	0.39	1.36	1.81	—	—	2.66	1/31/2009
Pure Gross of Fees	-0.04	1.14	-0.04	5.12	4.81	1.90	2.66	2.95	—	—	3.77	1/31/2009
Benchmark	-0.17	1.10	-0.17	5.25	5.34	1.93	2.84	3.21	—	—	4.13	—

*Cumulative total returns

Benchmark(s)

Benchmark = Bloomberg US Intermediate Credit Index

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Glossary

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

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.

Supranational bonds are debt instruments issued by supranational organizations, which are institutions created by the governments of several countries to promote economic, political, and social cooperation.

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