Franklin Income SMA

Commentary | as of June 30, 2025

Key Takeaways

- **Markets:** US stocks advanced during the second quarter of 2025 as equity markets rebounded from April's lows and continued to rally through June, despite bouts of volatility. Temporary delays in tariff hikes, reduced fears of a recession, growing expectations of interest-rate cuts later in the year and easing geopolitical tensions helped drive US stocks higher. Major US indexes fluctuated, but each posted positive returns by period-end.
- **Contributors:** Allocations to both the fixed income and equity sides of the portfolio contributed to the fund's absolute returns, while security selection and portfolio positioning assisted relative returns.
- **Detractors:** Stock selection and an underweight allocation to the industrials sector, as well as selection among health care companies, detracted from relative equity returns.
- **Outlook:** We remained selective among equities and added to high-quality names. Moreover, we reduced exposure to investment-grade corporate bonds and added to agency mortgage-backed securities to potentially enhance yield and diversification.

Performance Review

- The strategy **outperformed its benchmark**, the Blended 50% MSCI USA High Dividend Yield Index + 25% Bloomberg High Yield Very Liquid Index + 25% Bloomberg US Aggregate Index, for the quarter ended June 30, 2025.
- Over the course of the quarter, the strategy **decreased its fixed income allocation** and **increased its equity exposure**.
- Fixed income allocations to **the health care, consumer discretionary and industrials sectors had a positive effect** on absolute performance. However, **US Treasuries (USTs) hindered returns** during the period.
- On an individual issuer basis, **Community Health Systems, CommScope Holding and Tenet Healthcare were the top performers** within the strategy's fixed income positioning. In contrast, **Ingersoll-Rand and USTs detracted from returns**.
- In terms of equities, the strategy **benefited from positions within the information technology, financials and industrials sectors**. However, the **health care, energy and consumer staples sectors detracted** from absolute returns.
- **Morgan Stanley, JP Morgan Chase & Co. and Microsoft added value** within the strategy's equity holdings. Meanwhile, **Chevron, UnitedHealth Group and Exxon Mobil detracted from returns** during the period.

Outlook

- **Economy**: The economic growth outlook continues to be a major area of focus for the fund. The US economy remains resilient, but ongoing uncertainty in monetary, fiscal and trade policy may continue to weigh on investor sentiment and the broader economy in the second half of the year. Moreover, while the labor market has incrementally cooled, unemployment levels are still low on a historical basis. We continue to monitor financial conditions as a leading indicator of future economic performance and US Federal Reserve policy.
- **Equities**: Following two years of narrow market breadth, we started to see a broadening out of market leadership in the second half of 2024's calendar year, which continued through the market volatility in 2025's second quarter. While we remain selective in engaging with equities as index level valuations are elevated, opportunities are available below the index levels, which we feel favors active management.
- **Treasuries/Government-Backed Bonds**: The long end of the yield curve has been particularly volatile as the outlook for deficit spending, as well as longer-term economic growth and inflation expectations, has had a larger impact on the longest-dated bonds. Government securities continue to provide an attractive investment opportunity, in our view, as yields remain elevated based on recent history. We believe they continue to offer good diversification potential and can serve as a ballast to help hedge portfolios during market volatility.
- **Investment-Grade Corporate Bonds**: While absolute yield levels are still attractive for an income-generating strategy, credit spreads have contracted materially over the past year, which has decreased the attractiveness of investment-grade corporate bonds, in our assessment.
- **High-Yield Corporate Bonds**: Recent market volatility resulted in a combination of wider spreads and substantially higher yields, which has provided attractive investment opportunities, in our view. This opportunity was short-lived as spreads returned to relatively tight levels by the end of the quarter. While we think the high-yield market offers attractive yields, we remain balanced and selective due to the potential for higher refinancing costs impacting companies' fundamentals.

Top Holdings (% of Total)

Issuer	Portfolio
UNITED STATES TREASURY NOTE/BOND	6.49
FEDERAL HOME LOAN MORTGAGE CORP	3.10
CHS/COMMUNITY HEALTH SYSTEMS INC	2.81
GOVT NATL MORTG ASSN	2.45
SOUTHERN CO/THE	2.37
EXXON MOBIL CORP	2.24
JPMORGAN CHASE & CO	2.18
FREEPORT-MCMORAN INC	2.17
BOEING CO	2.17
CHEVRON CORP	1.84

Sector Allocation (Equity as a % of Total)

	Portfolio
Information Technology	8.27
Health Care	6.74
Energy	6.02
Industrials	5.59
Consumer Staples	5.37
Utilities	4.25
Financials	4.09
Consumer Discretionary	3.23
Materials	2.90
Communication Services	1.94

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	2.07	3.67	3.67	6.42	5.16	6.72	—	—	—	—	5.25	6/30/2019
Pure Gross of Fees	2.83	5.20	5.20	9.60	8.30	9.91	—	—	—	—	8.40	6/30/2019
Benchmark	1.44	4.67	4.67	9.23	8.06	6.75	—	—	—	—	5.68	—

*Cumulative total returns

Benchmark(s)

Benchmark =Blended 50% MSCI USA High Dividend Yield Index + 25% Bloomberg High Yield Very Liquid Index + 25% Bloomberg US Aggregate Index

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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" (3.0% is the maximum anticipated wrap fee for equity and balanced 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.
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What are the Risks?

All investments involve risks, including possible loss of principal. Generally, investments offering the potential for higher returns are accompanied by a higher degree of risk. Below investment grade bonds will have more credit risk and may be less liquid than higher-quality, investment grade bonds. Special risks are associated with foreign investing, including currency fluctuations, economic instability and political developments and investments. Other risks inherent in this strategy include interest rate risk and credit risk. Securities markets can fluctuate significantly in response to industry, financial or economic developments, and unexpected events, such as the spread of deadly diseases or disasters, can cause investor fear and panic, which can adversely affect companies, sectors and the market in general. Investors should review their investment objectives, risk tolerance and liquidity needs before choosing a manager. There is no guarantee that investment strategies will work under all market conditions and investors should evaluate their ability to invest for the long term, especially during periods of market downturns.Because the Franklin Income SMA Portfolio includes shares of no-fee funds which may engage in a variety of investment strategies involving certain risks, the portfolio is subject to those same risks.

Glossary

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

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