FRANKLIN TEMPLETON

Franklin Intermediate Government Bond SMA

Commentary | as of September 30, 2026

Key Takeaways

- **Markets**: Geopolitical developments remained a focus during the quarter, with receding expectations of a settlement nearer to quarter-end resulting in oil prices surging to over $100/barrel, compared to around $72/barrel in early July. This energy price move, combined with an increasingly hawkish central bank outlook, drove market moves, especially nearer the end of the quarter. The US dollar (USD) was modestly stronger over the quarter, with mixed performance against other currencies. Notably, the Japanese yen appreciated against the USD over the period as it benefited from intervention during the quarter. Following on increasingly hawkish rhetoric, the Federal Reserve (Fed) raised the fed funds rate by 25 basis points (bps) at its September meeting, retaining a hawkish outlook. US Treasury (UST) yields shifted higher across the entire curve in the quarter, with the increases focused on the intermediate and longer maturities, resulting in a steeper curve. The one-month UST bill yield rose by 23 basis points (bps) to 3.89%, while the three-month UST bill yield rose by 30 bps to 4.11%. Yields climbed further, by 72 bps to 4.89% on the two-year UST note, and by 86 bps to 5.09% on the five-year UST note. By the end of the quarter, the yield on the benchmark 10-year UST note had risen by 82 bps to 5.28% - its highest level since mid-2007 - while the yield on the 30-year UST bond was 68 bps higher at 5.63%.
- **Detractors**: Overweight exposures to the five- and 10-year segments of the yield curve.
- **Contributors**: Underweight to the two-year portion of the yield curve.
- **Outlook**: The September Federal Open Market Committee (FOMC) meeting reinforced our view that the Fed is committed to a higher-for-longer path. Following the September 25-bps hike, we anticipate a second increase by year-end, although we do not expect a return to 2022-style sequential hikes.

Performance Review

- Yield curve positioning had a negative impact on performance, led by overweight exposures to the five- and 10-year segments of the yield curve. However, an underweight to the two-year portion of the yield curve partially offset some of the losses.

Outlook

- In June, our view was that higher energy prices and supply-chain disruption would erode household purchasing power, lift firms' costs and potentially push the economy into a stagflationary drift. Three months later, the US inflation risk has not disappeared, but the economy has proven more resilient than expected. With inflation still above the Fed's target, the current macro backdrop is best described as a narrow, capital-intensive inflationary expansion, supported by strong underlying private demand, a stable labor market, corporate profitability and asset-rich households. Artificial intelligence (AI) investment remains the clearest source of US growth exceptionalism, but also the main pocket of overheating. Outside AI-linked manufacturing (computers/electronics, aerospace, electrical equipment), most industries remain well below capacity, and the industrial rebound has not produced a comparable hiring response, pointing to a capital- rather than labor-intensive cycle. The consumer is a key fault line. Real income is stagnant, the savings rate sits near cycle lows and spending is increasingly concentrated in essential services (health care, housing) and asset-price-sensitive financial services rather than broad discretionary demand. Tariff-refund-funded price cuts and strong corporate earnings offer a near-term cushion, but the support could fade. Overall, the consumer has continued to slow rather than break, leaving the outlook vulnerable to a softer labor market, equity-market correction or loss of refund-driven support.
- On interest rates, Fed Chair Kevin Warsh's Jackson Hole speech in August materially repaired July's communication problem, while the September FOMC meeting saw Warsh backing his rhetoric with action, as the Fed hiked by 25 bps. Moreover, this was more than a one-off adjustment. The Fed does not expect September's hike to be quickly reversed. The projected policy path is not merely higher in the near-term, it is higher for longer because the Fed sees a stronger economy, tighter labor market and more persistent inflation than it did in June. Our base case is for a second 25 bps increase by year-end. A third increase in 2027 remains a possibility should inflation prove sticky or accelerate. However, we do not see this as a return to 2022-style sequential hikes. With the September hike now in the rearview mirror, further upside to front-end yields depends mainly on whether incoming data validates the additional hike indicated in the Fed dot plot.

Not FDIC Insured | No Bank Guarantee | May Lose Value

Average annual total returns (%) - as of September 30, 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	-2.13	-2.33	-2.55	-1.89	2.24	-0.48	0.23	0.31	1.40	—	1.41	12/31/2003
Pure Gross of Fees	-1.77	-1.59	-1.45	-0.41	3.77	1.01	1.51	1.53	2.64	—	2.65	12/31/2003
Benchmark	-1.68	-1.51	-1.45	-0.32	3.78	0.57	1.28	1.39	2.50	—	2.51	—

*Cumulative total returns

Benchmark(s)

Benchmark =Bloomberg US Government - Intermediate 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%).

The **Federal Open Market Committee (FOMC)** is the branch of the Federal Reserve that dictates U.S. monetary policy, specifically targeting the federal funds rate and managing open market operations.

Stagflation is a seemingly contradictory condition described by slow economic growth and relatively high unemployment, or economic stagnation, which is at the same time accompanied by rising prices (i.e. inflation).

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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