FRANKLIN TEMPLETON

Franklin Intermediate Government Bond 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) remained on hold throughout the quarter. The March Federal Open Market Committee (FOMC) meeting statement and press conference emphasized uncertainty related to the Iran war, indicating that the Fed would look through any initial oil supply shock effect on inflation to focus on core developments, while also noting a likely dragging effect on the economy; ultimately the Committee retained an easing bias. Over the period, the US Treasury (UST) yields moved higher across the curve over the three-month period, resulting in a broader upward shift in the interest rate environment. The one-month UST bill yield increased by 10 basis points (bps), while the three-month UST bill yield rose by five bps. Yields climbed by 32 bps to 3.79% on the two-year UST note, and by 22 bps to 3.94% on the five-year UST note. By the end of the period, the yield on the benchmark 10-year UST note had risen by 15 bps to 4.32%, while the yield on the 30-year UST bond stood seven bps higher at 4.91%.
- **Contributors**: Underweight to the 10-year segment of the UST yield curve. Overweight to the five-year portion of the UST yield curve. Security selection among USTs.
- **Detractors**: Underweight to short-duration USTs.
- **Outlook**: Looking ahead into 2026, we have a favorable view toward the US economy, which remains resilient despite rising external pressures. Impending fiscal stimulus and an intact artificial intelligence (AI)-driven capital expenditure cycle could offset consumption drags. While our gross domestic product (GDP) growth forecast faces downside risks, structural expansion continues, making slower growth far more likely than a recession. Meanwhile, we expect the Federal Reserve to hold rates steady to combat any persistent inflation risks.

Performance Review

- Yield curve positioning contributed to performance, led by an underweight to the 10-year and an overweight to the five-year portions of the UST yield curve as yields rose during the quarter. In contrast, an underweight exposure to the two-year and shorter segment of the curve detracted from results. Security selection within US Treasuries added to overall returns.

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. Meanwhile, the AI-driven capital expenditure (capex) cycle remains intact. Our above-consensus forecast of 3.0% for 2026 US 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. We expect the Fed to remain on hold through the end of Chair Jerome Powell's term and potentially throughout the year given rising upside risks to inflation. Should inflation broaden beyond energy and become persistent, the Fed could be forced to keep rates higher for longer or even consider renewed tightening.
- While the 2026 FOMC 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 US Treasury yields should drift higher, though somewhat favorable demand-supply technicals may limit the extent of this move.

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	-0.23	0.45	-0.23	2.39	2.44	-0.02	0.51	0.75	1.66	—	1.55	12/31/2003
Pure Gross of Fees	0.15	1.20	0.15	3.92	3.97	1.48	1.77	1.96	2.90	—	2.79	12/31/2003
Benchmark	0.05	1.21	0.05	3.98	3.65	1.00	1.53	1.85	2.74	—	2.63	—

*Cumulative total returns

Benchmark(s)

Benchmark =Bloomberg US Government - Intermediate 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" (1.5% is the maximum anticipated wrap fee for fixed income 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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All investments involve risks, including possible loss of principal. To the extent the portfolio invests in a **concentration of certain securities, regions or industries,** it is subject to increased volatility. **Fixed income securities** involve interest rate, credit, inflation and reinvestment risks, and possible loss of principal. As interest rates rise, the value of fixed income securities falls. **Liquidity risk** exists when securities or other investments become more difficult to sell, or are unable to be sold, at the price at which they have been valued. **Active management** does not ensure gains or protect against market declines. The portfolio is **non-diversified** and may invest in a relatively small number of issuers, which may negatively impact the performance and result in greater fluctuation in value. The manager may consider **environmental, social and governance (ESG) criteria** in the research or investment process; however, ESG considerations may not be a determinative factor in security selection. In addition, the manager may not assess every investment for ESG criteria, and not every ESG factor may be identified or evaluated.

Glossary

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

Capital Expenditure (capex) are funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment.

Duration is a measure of the sensitivity of a bond's price to changes in interest rates.

Gross domestic product (GDP) is the market value of all final goods and services produced within a country in a given period of time.

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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