FRANKLIN TEMPLETON

June 30, 2026

Midyear Review: Franklin Small Cap Value Fund

Key Takeaways

- Small-cap stocks had a strong start to the year, with a favorable interest rate environment bolstering many indebted companies and strong earnings growth boosting the broader small-cap universe.
- The Franklin Small Cap Value Fund (Advisor Class without sales charges) was up strongly on an absolute basis, but did not fully keep pace with its benchmark, the Russell 2000 Value Index, given the surge in lower quality and microcap names during the first six months of the year.
- Longer-term, we continue to expect stronger earnings growth and a favorable interest rate environment, particularly should oil price pressures further ease, to bolster smaller company stocks.

Market review

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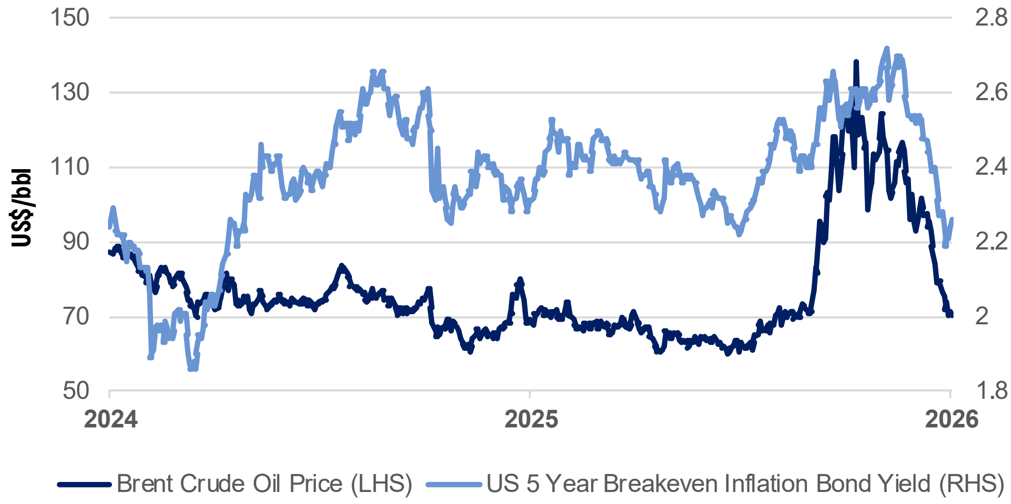
Inflation expectations rose amid the rise in oil prices but have started to abate given negotiations to fully end the conflict in the Middle East. Exhibit 1 shows oil prices and the yield on the 5-year Treasury Inflation-Protected Security (TIPS). TIPS yields rise on greater inflation expectations and fall as inflation worries recede.

Exhibit 1: As Oil Prices Decline, Interest Rate Expectations Follow

US 5-Year Breakeven Inflation Bond Yield and Oil Price

June 30, 2024 to June 30, 2026



Source: FactSet, Commodity Research Bureau, Federal Reserve Bank of St. Louis.

Should oil prices continue to fall as tensions in the Strait of Hormuz start to dissipate, and oil shipments further normalize, it could reduce the need for higher rates and allow small caps to continue their advance.

In either event, we believe the longer-term outlook for smaller value companies remains positive. With solid earnings and still appealing valuations, quality small-cap companies can generate attractive investor returns over time.

Fund performance

The Franklin Small Cap Value Fund delivered strong absolute returns but trailed its benchmark, the Russell 2000 Value Index, given the strength in microcaps and lower-quality companies during the runup. The Fund's solid absolute performance reflects our focus on well-run quality companies that can generate long-term value for investors.

Security selection in the information technology sector weighed on relative results, as some of the Fund's biggest detractors and biggest contributors came from the sector. Detractors included transportation technology company Vontier and payments company ACI Worldwide. Despite delivering another strong quarterly earnings report, ACI Worldwide declined as valuations across payment companies compressed amid persistent concerns about potential disintermediation from AI and emerging fintech technologies, such as blockchain.

Conversely, stocks with exposure to the AI-investment theme had a strong first half of the year, including MKS, which supplies instruments, subsystems, systems, process control technologies and specialty chemical products used in manufacturing semiconductors, and semiconductor manufacturing software company Onto Innovation and chip company Cohu. Additionally, industrial firm Valmont Industries should benefit from the continued buildout of the power grid in part to help service rising demand due to data center construction.

A handful of consumer companies weighed on relative results, given concerns about a possible slowdown in consumer spending. Toymaker Mattel hampered relative performance, as did clothing retailer Gap. While recent earnings have shown an improvement in the Gap brand, the Old Navy business has seen step-backs in performance recently. Since Old Navy drives the bulk of earnings, we need to see progress at the brand for the stock to improve.

Also, UK defense companies Babcock International Group and QinetiQ weighed on relative performance, as uncertainties surrounding the UK defense budget and leadership in parliament have weighed on the stocks, despite our expectations for strong regional European defense spending over time. Another UK-based defense company contributed after a takeover offer from private-equity buyers.

The conflict in the Middle East and the spike in energy prices in early 2026 due to the closure of the Strait of Hormuz boosted shares in Select Water which provides water infrastructure and solutions to the fracking industry. We believe the company is growing its water infrastructure business rapidly, which has both long-term contracts with the oil and gas exploration and production industry and attractive returns.

Portfolio positioning

Although AI has been the primary focus of markets in recent months, we are increasingly seeing opportunities in other areas as the market looks set to broaden over the back half of the year. As such, we have reduced exposure to several AI-related stocks following the rally and have added new positions in a range of sectors and industries, from industrials and energy to metals and mining and biotechnology.

In the industrials sector, we have found an opportunity in a UK-based but US-focused firm that has been consolidating private equity owned manufacturing businesses and using a buy, improve and sell model to take advantage of a renaissance in US manufacturing and a need for private equity time-based exits. We also added a building products company, that has seen its stock price decline amid a weak US home remodeling market. However, it is a high-quality business with a strong plumbing unit, and we expect an eventual uptick in home repair and remodeling spending should interest rates continue to fall alongside easing inflationary pressures.

Energy stocks also are an attractive area of new investment ideas, particularly given the spike in oil prices following the closure of the Strait of Hormuz. We have found opportunities in companies that provide robotics and other services to the offshore energy sector, as well as firms that provide drilling services to the oil and gas industry.

Also in the resource industries, we found opportunities in the metals and mining industry, adding both a gold and a copper miner to the portfolio. Gold miner valuations do not reflect spot gold prices, in our view, as the market does not have confidence in the duration of cash flow generation at these levels and the opportunity to reinvest that cash productively. Meanwhile, the copper miner, which has mines in Brazil, should benefit from strong growth as investors await signs of a more stable operating performance.

In health care, the Fund added a specialty pharma company focused on opioid treatments as the stock does not reflect the strong earnings growth from its main treatment. The Fund is also finding new opportunities in biotechnology, an industry we have often struggled with finding companies that meet our investment criteria.

With all our new additions, we remain focused on profitable, higher quality stocks, which we define as stocks with positive or growing earnings and low leverage, stable business models and good corporate governance, trading at depressed prices relative to their future earnings power.

Outlook

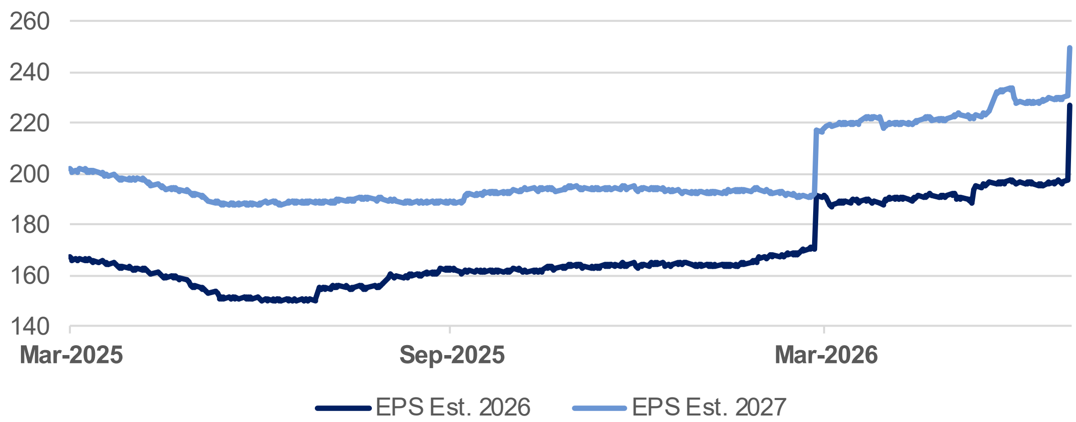
Several factors should continue to underpin strong small-cap stock performance in the back half of 2026. First, a strong US economy has led to faster earnings growth over the past few quarters, but earnings for smaller companies are still below their most recent peak.

As data center and other capital investment underpins US economic activity, we could see additional earnings growth opportunities for domestically focused small-cap companies. Small-cap companies' earnings are projected to grow 10% over the coming year, according to data from Bloomberg. (Exhibit 2).

Exhibit 2: Expected Russell 2000 Value EPS Growth for 2026 is 10% Higher than 2025

Russell 200 Value Projected EPS Levels as of X-axis Dates

March 3, 2025 to June 30, 2026



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Meanwhile, valuations remain attractive. Although price/earnings ratios for profitable small-cap companies have steadily risen over the past few months, they remain below recent peaks and stocks are still much cheaper than large-cap equities.

The interest rate environment also remains appealing, even as inflation remains a persistent concern. So long as US interest rates remain low, small-cap performance can benefit, in our view. Lower rates help stimulate the economy through better housing demand and increased money supply. Lower short-term rates and increased economic optimism, which usually accompany a steeper yield curve, have historically coincided with a strong performance in small-cap stocks (Exhibit 3). In addition, lower rates make it easier for indebted small-cap companies to manage their balance sheets.

Exhibit 3: A Steepening Yield Curve Has Historically Meant Strong Small Cap Performance

Russell 2000 Value Index vs. the US 2-10 Treasury Yield Spread

January 3, 2014 to June 30, 2026

Sources: Bloomberg, Russell. Frank Russell Company is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Frank Russell Company. Indexes are unmanaged, and one cannot invest directly in an index. They do not reflect any fees, expenses or sales charges. **Performance shown represents past performance and is no guarantee of future results.**

And should lower oil prices alleviate any need for higher interest rates, small-cap stocks could add to their advance in late 2026, in our view.

As such, we remain optimistic about the prospects for small-cap value stocks over the back half of the year. Remaining consistent and focusing on quality names can generate long-term value for investors, in our view.

Top 10 Holdings	Ending weights as of 6/30/2026
ACI Worldwide Inc.	3.52%
Ashland Inc.	3.28%
Select Water Solutions Inc.	3.07%
Bruker Corp.	2.68%
Rosebank Industries PLC	2.64%
CNO Financial Group Inc.	2.62%
Columbia Banking System Inc.	2.61%
Southstate Bank Corp.	2.45%
WSFS Financial Corp.	2.41%
Horace Mann Educators Corp.	2.14%

Average Annual Total Returns (%) at NAV as of June 30, 2026	6-Month	1-Year	3-Year	5-Year	10-Year	Since Inception	Inception Date
Advisor Class (With Sales Charges)	21.24	32.32	15.99	9.08	10.90	9.93	3/11/1996
Advisor Class (Without Sales Charges)	21.24	32.32	15.99	9.08	10.90	9.93	3/11/1996
Class A (With Sales Charges)	14.42	24.71	13.54	7.59	10.00	9.38	3/11/1996
Class A (Without Sales Charges)	21.08	31.98	15.7	8.81	10.63	9.58	3/11/1996
Russell 2000 Value Index	22.99	43.01	18.72	8.24	10.90		

Performance data quoted represents past performance, which does not guarantee future results. *Current performance may be lower or higher than the figures shown. Principal value and investment returns will fluctuate, and investors' shares, when redeemed, may be worth more or less than the original cost. Performance would have been lower if fees had not been waived in various periods. Total returns assume the reinvestment of all distributions and the deduction of all fund expenses. Returns for periods of less than one year are not annualized. All classes of shares may not be available to all investors or through all distribution channels. For current month-end performance, please call Franklin Templeton at (800) DIAL BEN/342-5236 or visit* www.franklintempleton.com.

An investor cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

Periods shorter than one year are shown as cumulative total returns.

			Sales Charges		Expenses	
Share Class Details	**CUSIP**	**Ticker**	**Max**	**CDSC**	**Gross**	**Net**
Class Z	355148503	FVADX	0.00%	–	0.73%	0.72%
Class A	355148305	FRVLX	5.50%	–	0.98%	0.97%

Gross expenses are the fund's total annual operating expenses as of the fund's prospectus available at the time of publication. Actual fees may be higher and may impact portfolio returns. Net expenses reflect contractual fee waivers, expense caps and/or reimbursements, which cannot be terminated prior to 2/28/2027 without Board consent. Actual expenses may be higher and may impact portfolio returns.

The **Russell 2000 Value Index** measures the performance of the small-cap value segment of the US equity universe. The **Russell 1000 Value Index** measures the performance of the large-cap value segment of the US equity universe. Source: FTSE. Important data provider notices and terms available at **www.franklintempletondatasources.com**. All data is subject to change.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal. Small- and mid-cap stocks involve greater risks and volatility than large-cap stocks. The **investment style** may become out of favor, which may have a negative impact on performance. **International investments** are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in **emerging markets**. **Real estate investment trusts (REITs)** are closely linked to the performance of the real estate markets. REITs are subject to illiquidity, credit and interest rate risks, and risks associated with small- and mid-cap investments. 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. These and other risks are discussed in the fund's prospectus.

IMPORTANT LEGAL INFORMATION

The information provided is not a complete analysis of every material fact regarding any country, market, industry, security or fund. Because market and economic conditions are subject to change, comments, opinions and analyses are rendered as of the date of this material and may change without notice. A portfolio manager's assessment of a particular security, investment or strategy is not intended as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy; it is intended only to provide insight into the fund's portfolio selection process. Holdings are subject to change.

Before investing, carefully consider a fund's investment objectives, risks, charges and expenses. You can find this and other information in each prospectus, or summary prospectus, if available, at www.franklintempleton.com. Please read it carefully.

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Due to continued strong inflows and increased assets under management, Franklin Small Cap Value Fund closed to new investors with limited exceptions effective May 27, 2021. Existing shareholders may continue to add money to their accounts.

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