FRANKLIN TEMPLETON

Franklin Strategic Income Fund

Series A
Series F
March 31, 2021

Fund Commentary

Performance Review

- As investors coped with potential inflation concerns related to monetary and fiscal stimulus (past and future) and improving economic growth expectations, US Treasury (UST) yields surged during the quarter. Fixed income performance, however, was mixed with higher-quality sectors, including investment-grade (IG) corporate debt, generally posting negative returns whilst others, such as high-yield (HY) corporate bonds, senior secured floating rate debt and collateralised loan obligations (CLOs), had positive returns. Fixed income spreads broadly tightened from the prior quarter-end.
- For the quarter, the fund's Series F shares returned -1.20%, and its benchmark, the Bloomberg Barclays U.S. Aggregate Index (Hedged to CAD), returned -3.38%.

QUARTERLY KEY PERFORMANCE DRIVERS

	Sector Exposure	Duration/Yield Curve
HELPED	Corporate Credits: High-Yield (HY) and IG Corporate Bonds, Senior Secured Floating-Rate Bank Loans and Collateralised Loan Obligations (CLOs)	—
	Non-Agency Residential Mortgage-Backed Securities (RMBS), Taxable and Tax-Exempt Municipal Bonds and US Treasury Inflation-Protected Security (TIPS)	—
	Sovereign Developed Market and Emerging Market (EM) Debt; Non-US Dollar Denominated EM Debt	—
HURT	Foreign Currency Exposure	US Duration Positioning
	—	Non-US Duration Positioning
	—	—

- The fund's exposure in the corporate credit sectors of HY and IG corporate bonds, senior secured floating-rate bank loans and CLOs was the main contributor to absolute returns (especially HY corporate bonds). We added to HY corporate bonds and senior secured floating-rate bank loans and pared our allocation to IG corporate bonds and CLOs during the quarter. Given tighter valuations in the IG sector, we remain generally comfortable with fundamentals and market technical conditions. We further believe that the medium-term risk environment remains generally positive, helped by strong growth prospects, supportive fiscal and monetary policy, and a visible path towards containment of COVID-19 cases as we go through 2021. We remain constructive on the HY asset class. We also believe HY corporate bonds stand to benefit from an accelerating vaccine distribution and an additional large-scale fiscal stimulus package. There is room for further HY spread compression to absorb a relatively orderly rise in rates given that spreads remain materially wide of historical and post-global financial crisis tights across ratings tiers, in our view.
- Our RMBS allocation was another major contributor to returns. Our remaining exposure is in holdings with significant locked-in home equity, where slower prepays due to lock out and higher rates should allay negative convexity concerns and boost returns for premium priced securities. Fundamentally, housing remains strong and housing activity firm and we still expect select non-agency RMBS to provide consistent risk-adjusted returns
- TIPS performance contributed to results during the quarter. Conversely, our foreign-currency exposure hindered results, mainly from our long positions in the Japanese yen and euro.

Outlook & Strategy

- With household finances already at high levels and an economy that has demonstrated its ability to rebound, the unprecedented onslaught of policy stimulus (such as the US$1.9 trillion fiscal stimulus bill and a potential US$3 trillion infrastructure package) greatly increases the chance that the US economy will overheat over the course of this year and next. The reflation debate, still dormant three months ago, is now in full swing. The consensus still gravitates around the US Federal Reserve's (Fed's) reassuring official view: inflation expectations will remain well-anchored, wage pressures will remain moderate, the inflation rebound will be temporary and the Fed will smoothly adjust policies once it has reached its targets. We believe it is important not to ignore the risks: the government is providing a staggering amount of stimulus to an already recovering economy, at a time when commodity prices are already rising, reflecting both the global recovery and supply constraints caused by the pandemic. The inflation rebound might exceed expectations; if it does, and policy remains highly accommodative, inflation expectations might rise beyond what the Fed expects. Meanwhile, a very significant rise in public debt will compound macro uncertainty.
- Overall, we expect that the coming months and quarters will see a consolidation of a robust recovery in the US and in the global economy at large, with Europe catching up in the latter part of the year. Together with vaccinations, fiscal policy plays a key role in this recovery, notably in the US. Going forward, we believe markets will increasingly focus on whether this can be too much of a good thing: whether the massive fiscal stimulus, enabled by an extremely stimulative monetary stance, will cause the economy to overheat and inflation pressure to build beyond central bank's expectations and desires. We do not expect inflation to get out of hand; but given that policymakers have now pulled all stops, we suspect that managing their desired inflation rise will prove harder than they think and claim. This could easily bring heightened stress and volatility to financial markets where prolonged massive monetary easing has already contributed to stretched valuations across asset classes.

Fund Details

Inception Date	02/17/2003
Benchmark Name	Bloomberg Barclays U.S. Aggregate Index (Hedged to CAD) (USD)

Fund Description

The Fund seeks high current income and some long-term capital appreciation by investing primarily in fixed income securities issued in the United States and throughout the world.

Performance Data

Performance (%) as of 03/31/2021

	1 Mth	3 Mths	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs	Since Inception	Inception Date
Series A	-0.72	-1.33	-1.33	7.93	1.75	2.18	2.22	2.05	02/17/2003
Series F	-0.67	-1.20	-1.20	8.52	2.36	2.72	2.91	2.88	02/17/2003
Bloomberg Barclays U.S. Aggregate Index (Hedged to CAD)	-1.25	-3.38	-3.38	0.51	4.14	2.63	3.58	4.15	-

Indicated rates of return include changes in unit or share value and reinvestment of all distributions and dividends and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. Index rates of return are as shown in their indicated currency. Please refer to the prospectus for further details. **For details on the respective series inception dates, please consult the Fund Facts or simplified prospectus for the fund.** Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. **Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.**

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Series F is available to investors participating in programs that do not require Franklin Templeton to incur distribution costs in the form of trailing commissions to dealers. As a consequence, the management fee on Series F is lower than on Series A.

Indexes are unmanaged, and one cannot invest directly in an index. They do not reflect any fees, expenses or sales charges.

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