January 2024

Franklin Templeton Fixed Income

Fixed Income Views

Volume 17—Are central banks already taking a victory lap?

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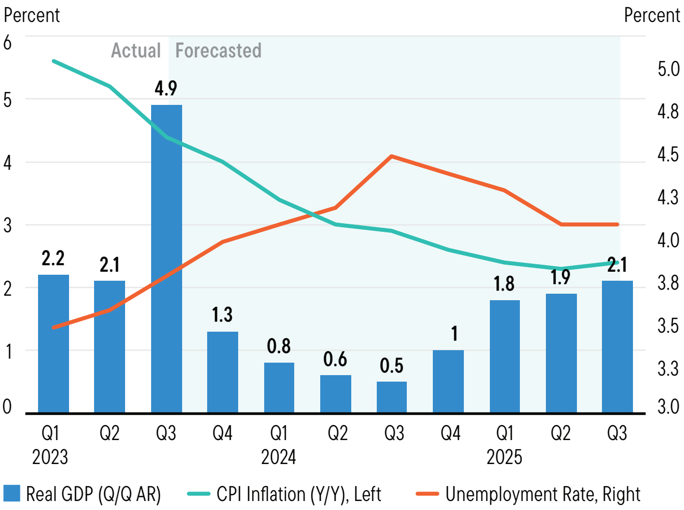
Executive summary

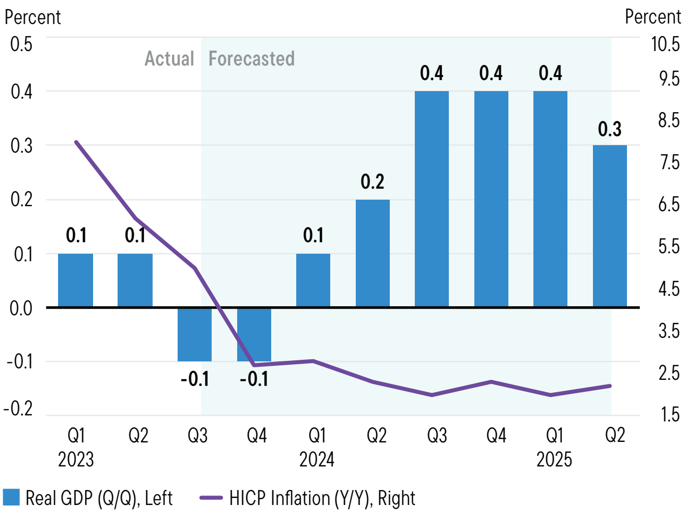
Our growth projections for the United States continue to improve as a "soft landing" becomes the most likely outcome, while other economies may face harsher conditions. US and European central banks appear to have reached the peaks of their hiking cycles, but we believe it is still too soon to declare victory against inflation. A core tenet of our macro view is central banks will need to maintain rates at higher levels than the market anticipates, which will keep pressure on yields across the curves.

We are still cautious about taking broad-based risks as spreads are currently not pricing in any potential downside; however, all-in yields remain at historically high levels making them appear attractive to us. We are finding pockets of value across several sectors and are focusing on security selection.

US Economic Forecasts



European Economic Forecasts



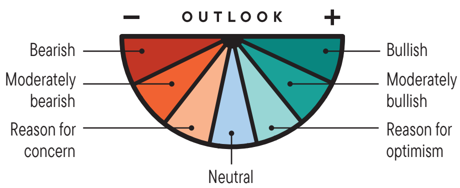
Sources: US Census, NAR, Macrobond. As of December 31, 2023. There is no assurance any forecast, projection or estimate will be realized.

Fixed income outlook dashboard

Outlooks for fixed income sectors are based on our analysis of macroeconomic themes and the technical conditions for each asset class. We rate each sector from bearish to bullish to express our outlook over the next six to 12 months.

6–12 Month Outlook / Sector	Prior Quarter View
Moderately Bullish	
Tax-Exempt Municipal Bonds	Moderately Bullish
US Treasury Inflation-Protected Securities	Moderately Bullish
Reason for Optimism	
Collateralized Loan Obligations	↑ Neutral
Euro Investment-Grade Bonds	Reason for Optimism
Mortgage-Backed Securities (MBS)	↑ Neutral
US High-Yield Corporates	↑ Neutral
Neutral	
Asset-Backed Securities	Neutral
Emerging Markets Corporates	Neutral
Emerging Market Sovereign Debt	↓ Reason for Optimism
Euro High-Yield Corporates	Neutral
Floating-Rate Loans	Neutral
Non-Agency Residential MBS	Neutral
Reason for Concern	
Commercial Mortgage-Backed Securities	Reason for Concern
Eurozone Government Bonds	↓ Neutral
US Investment-Grade Corporates	↑ Moderately Bearish
US Treasuries	Reason for Concern
Moderately Bearish	
Global Sukuk	Moderately Bearish
Bearish	
Japanese Government Bonds	Bearish

Understanding the pendulum graphic



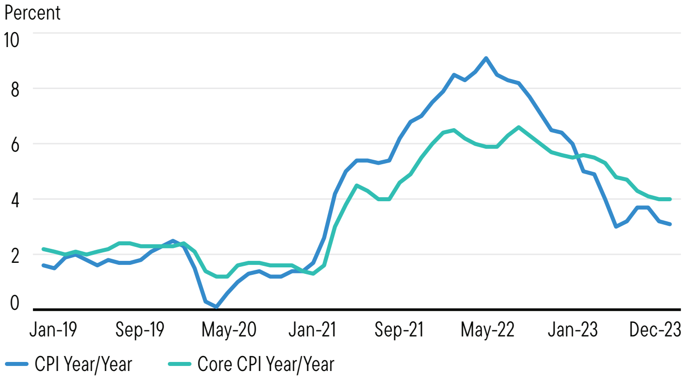
Macroeconomic themes

Fed narrative changes, but inflation battle not won

After reaching the 5% level in late October, yields on 10-year US Treasuries (USTs) dropped more than a full percentage point (pp) on slightly cooler economic data and a surprisingly dovish pivot from the Fed, leading markets to price in nearly 150 basis points (bps[1]) of rate cuts in 2024. The UST market rally has loosened financial conditions to mid-2022 levels, nullifying almost 375 bps of tightening. Whether the Fed was right to pivot so soon will depend entirely on the trajectory of inflation and employment. Very little in the incoming economic data over the last few months has warranted such an expansive change in the Fed's narrative. The last mile of disinflation could still prove to be difficult. Continued economic strength would suggest that monetary policy is not too restrictive, giving the Fed room to hold the current policy stance longer.

Core CPI Disinflation Shallower

As of December 30, 2023



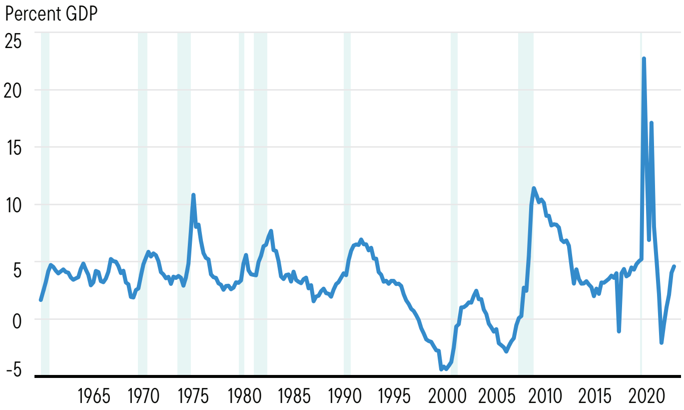
Source: Bureau of Labor Statistics.

Still healthy private sector surplus

The private sector financial balance is the difference between the current account balance and the fiscal balance. A deficit would indicate that households and firms are unable to finance their spending out of their incomes, having to instead rely on credit/borrowing or asset sales to bridge the funding gap. The US private sector balance is, however, at a significantly healthy 4.6% of gross domestic product (GDP), compared to –4.4% in the third quarter of 2000 and –2.7% in 2006. This implies that in the event of a banking sector crisis or asset market decline, should the supply of credit dry up, households and firms should still be more than able to meet their current expenses from their incomes.

US Private Sector Running a Healthy Surplus

As of December 8, 2023



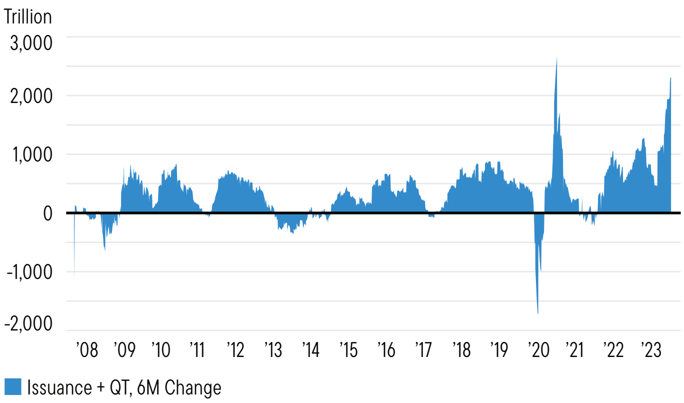
Sources: FTFI Research, BEA, Macrobond.

Uncertainty around the US economy continues

The impact of rising fiscal deficits, growing UST issuance, quantitative tightening, the changing buyer base of USTs, a resilient US economy (given that consumers have continued to spend), and temperamental energy markets are suggestive of structurally higher inflation and interest rates. Consequently, we believe it has become tougher to define the kind of "landing" the economy is likely to see. In the United States, a still-tight labor market, persistently solid household spending, and robust balance sheets amid record homeowners' equity for their real estate holdings bolster the case for a soft landing. Conversely, the rise in longer-term rates makes the soft-landing scenario in United States more challenging.

"Effective Bond Supply" Has Soared Recently

As of November 14, 2023



Sources: FTFI Research, US Department of Treasury, Macrobond.

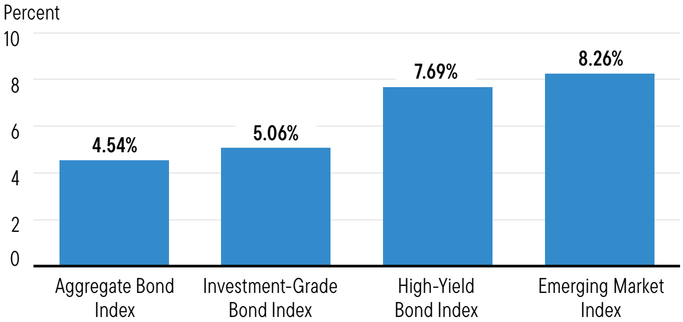
Portfolio themes

Yield investors provide a technical tailwind to credit

In our analysis, nominal yields across broad fixed income sectors are attractive on a historical basis, providing significant income opportunities. The fear of missing out (FOMO) on these high yields has some investors looking at outright yield levels and not spreads. This has allowed spreads to migrate tighter than longer-run averages despite weakening US economic prospects. Higher income levels reduce the potential for negative absolute returns even in a modest spread widening scenario. We maintain our valuation discipline to ensure we are appropriately compensated for risk.

Index Yield to Worst

As of December 31, 2023



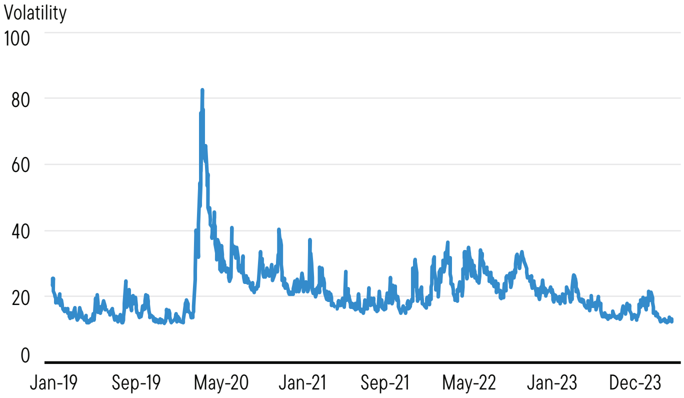
Source: Bloomberg. The aggregate bond index is represented by the Bloomberg US Aggregate Bond Index; The aggregate bond index is represented by the Bloomberg US Corporate Bond Index. The investment-grade bond index is represented by the Bloomberg US Corporate Bond Index. The high-yield bond index is represented by the ICE BofA US High Yield Constrained Index. The emerging market index is represented by the JP Morgan EMBI Global Diversified Index. Yield-to-worst is the lowest yield available on bonds with early retirement options. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

Market discounting downside risk

Implied volatility measures in fixed income spread sectors remain too low, in our view, given the still uncertain path of the global economy. The equity volatility index VIX, a good proxy for market risk appetite, is on the lower end of recent history. Also, fewer fixed income investors have employed derivatives to protect against market volatility. We remain vigilant in evaluating the impact of a slowing economy and higher interest rates. By tiering risk parameters across fixed income sectors, we can more efficiently construct portfolios with an eye toward limiting the downside risk without sacrificing current market returns.

VIX

As of December 31, 2023



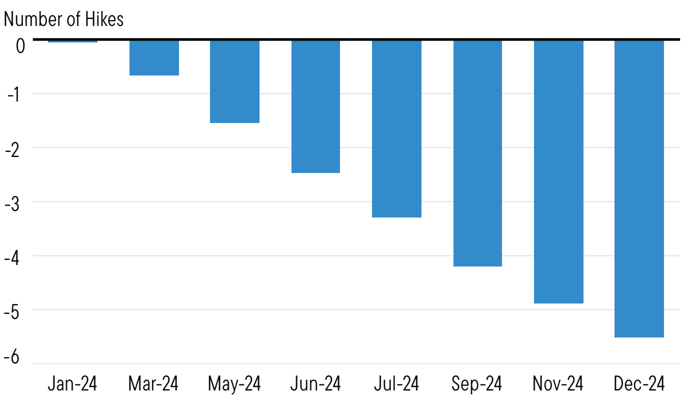
Source: Bloomberg.

Follow the Fed speak

The market is pricing in an aggressive path of Federal Reserve (Fed) rate cuts by the end of next year. This is too much, too soon as the Fed will need to remain in restrictive territory for as long as necessary to bring inflation down, in our view. Market expectations of Fed cuts have kept intermediate yields low, making the Fed's efforts to restrict lending to consumers and businesses more difficult. The Fed will have limited ability to cut rates as fast as the market is forecasting as long as disinflation remains a challenge. Even with moderating inflation, the Fed should proceed cautiously, as any resurgence would be damaging to the market. We have positioned our portfolios to benefit as the market adjusts to a more realistic Fed path.

Fed Hike/Cuts

January 9, 2024



Source: Bloomberg. There is no assurance that any estimate, forecast or projection will be realized.

US economic review

Underlying macro fundamentals still point to structurally higher US Treasury Yields

- US bond supply dynamics have deteriorated significantly in 2024. Effective bond supply soared by a staggering $2.3 trillion since May 2023. That number is only dwarfed by a larger issuance in 2020, but that was obviously under different circumstances. Given "normal" economic conditions, the market is being forced to absorb an unprecedented amount of issuance.

- The fiscal front alone is going to keep bond supply dynamics challenged in the medium term. The Congressional Budget Office continues to project elevated deficits, with interest costs expected to account for an increasing share of the deficit. Moreover, the wider deficit in fiscal year (FY) 2023 had little to do with Congress' approval of three major infrastructure laws to fund investment in semiconductors, green energy and transportation. Instead, it was a decline in tax receipts that more than offset the decline in spending. Unlike FY 2023, spending will likely see an uptick next year, especially given an election year.

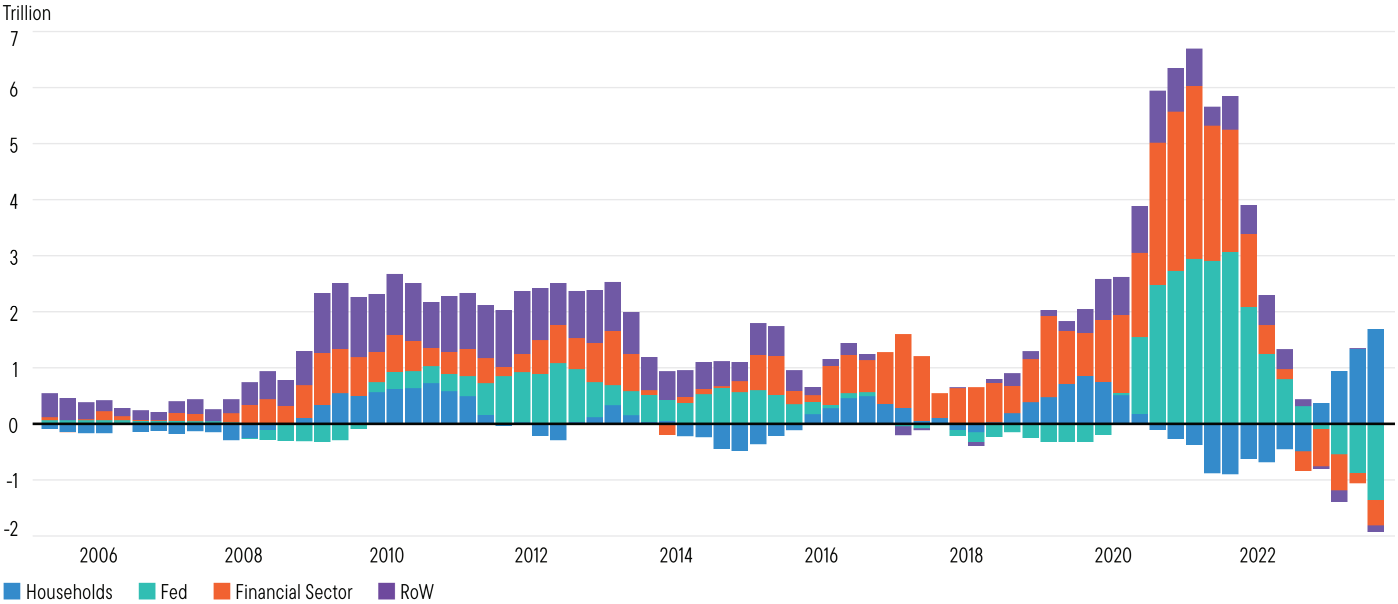
- The Fed's quantitative tightening (QT) program is another source of worsening bond supply dynamics. Adding the Fed's annual balance sheet runoff of US$900 billion to the federal budget deficit of US$1.7 trillion, means that the net supply of UST expanded by nearly 10% of GDP in FY 2023. QT will likely continue until bank reserves with the Fed reach 8%–9% of GDP (currently 12%), meaning QT is likely to continue for at least a minimum of a year (if not longer). Moreover, the drain in liquidity is coming precisely at a time when the US Treasury is ramping up the volume of securities that market participants need to absorb and finance.

- With the Fed, banks, non-bank financials and overseas investors turning net sellers of USTs over the past year, US households, historically the smallest holders of USTs, have essentially become the marginal buyers. Households have increased their holdings by US$1.7 trillion in less than two years, taking them to a new high of US$2.4 trillion. Compared to other rather inelastic buyers of USTs historically, households are likely to be much more price sensitive. The level of sensitivity will largely depend on their inflation outlook. While markets have taken a largely sanguine view of inflation, households have been much less optimistic. That excess (1–1.5 percentage points) of US households' long-term inflation expectations over market break evens (at nearly 15-year highs) potentially serves as a rough estimate of the additional yield compensation that households could demand.

In sum, despite the more recent change in the Fed's narrative on rate cuts for 2024, we believe the impact of rising fiscal deficits, growing UST issuance, QT, the changing buyer base of USTs, a resilient US economy (given that consumers have continued to spend) and temperamental energy markets have together stoked a view of structurally higher inflation and interest rates.

Changing Buyer Base for US Treasuries

As of November 14, 2023



Sources: FTFI Research, Federal Reserve, Macrobond.

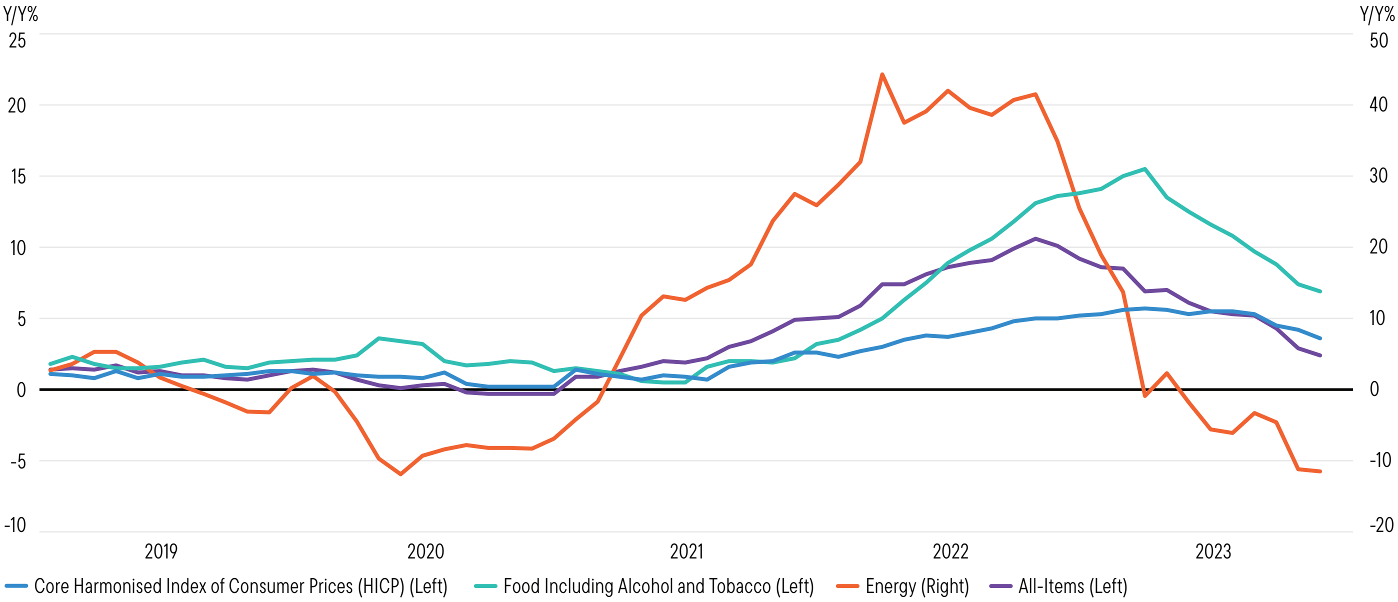
Euro area economic review

Navigating the pause

- Economic growth in the euro area (EA) remains lackluster, with real GDP broadly stagnant over the past few quarters, and the trend likely to continue into 2024. The manufacturing sector is still under pressure, but we expect that falling headline inflation combined with rising nominal wages should support the economy going forward, mitigating a more severe downturn. In fact, the third quarter of 2023 saw real private consumption pick up modestly in some countries, such as Spain and France.
- We see some potential downside risks for the coming months, as sentiment indicators remain subdued. We therefore expect marginally negative growth in the fourth quarter of 2023, marking a shallow technical recession. Following this, we are penciling in some pick-up in momentum over the second half of 2024.
- The European Central Bank's (ECB's) unprecedented streak of 10 consecutive policy rate hikes is certainly weighing on growth, with surveys showing continued downward surprises to credit conditions and demand, both for households and corporates. Although the peak impact of monetary transmission to financing conditions appears behind us, the prolonged deleveraging, particularly in periphery countries, suggests that some more strain may lie ahead.
- Meanwhile, the labor market is still tight by historical standards as the unemployment rate remains at its historical lows. However, there are signs of cooling as employment growth is stagnating and vacancies are trending down. Overall, job shedding should remain modest, supported by labor hoarding due to skill shortages (especially in the services sector). Consequently, wages are likely to continue to catch up to inflation throughout the coming year.
- Despite the pressure that rising wages may continue to put on services inflation, the headline measure is trending down and reached a more than two-year low in November.[2] Core inflation also eased, leading investors to bring forward their expectations of a first ECB policy rate cut. Volatile energy prices could pose some upside risks to inflation over the coming quarters, but the overall deflationary trend seems to be validated.
- The ECB pushed back against market expectations of imminent rate cuts, as it continues to judge its current monetary policy setting, if maintained long enough, to be sufficiently restrictive to bring inflation back to target. Labor cost and profit developments will remain in the spotlight in the coming months as the ECB seeks evidence of a sustained normalization process of inflation. This implies to us that rate cuts before the summer of 2024 are highly unlikely, except in the event of a severe economic downturn, which we do not currently expect. On the balance sheet front, reinvestments of the pandemic emergency purchase program (PEPP) will be reduced by around half starting in the second half of 2024.

Year-Over-Year (Y/Y) Disinflationary Trend is Continuing

As of December 12, 2023



Sources: Franklin Templeton Fixed Income Research, Eurostat, Macrobond.

Commercial real estate realities—Pandemic reckoning and WeWork's uncharted journey

With co-working being one of the largest categories of office space, the decline of WeWork mirrors what is happening in office CRE and the challenges the CMBS sector faces.

- There has been a lot of attention given to the ever-worsening office sector of commercial real estate (CRE) with headlines capturing defaults. WeWork, who was supposed to challenge the dynamic of shared office use, filed for bankruptcy on November 7. With co-working being one of the largest categories of office space, the decline of WeWork mirrors what is happening in office CRE and the challenges the commercial mortgage-backed securities (CMBS) sector faces. CMBS are securitized packages of CRE loans that have been combined into a tradable security. One of the most common forms of CMBS is a conduit deal where there is a large, diversified package of loans from various CRE sectors—including office, retail, industrial and multi-family—with office loans making up about 28% of conduit CMBS collateral.[3] CMBS deals then issue securities with various credit ratings, exposure to defaults and targeted maturities.
- COVID-19 brought a tectonic shift in the way Americans work as people find it easy and more enjoyable to work from home, eliminating long commutes. WeWork has found it difficult to attract workers back to its hotel-type office space. The company's return-to-office (RTO) initiatives have languished. Overall occupancy is still low as offices in the top 10 cities are 50% occupied.[4] We project office vacancies will continue to rise nationwide peaking at 19.5% in 2023.
- CMBS deals are seeing the highest delinquency rates since the global financial crisis (GFC). Although there has been an uptick in delinquencies across all CRE segments, office loans have shown the largest increase, jumping to 5.75% in October 2023, up from 1.75% in the same period in 2022.[5] We project the trend should continue.
- There remain secondary effects to the drop in office CRE valuations impacting US banks and municipal (muni) bonds issuers. We believe large globally systemically important and regional banks' overall CRE holdings remain within reasonable levels, and the banks are effectively managing the issues with limited overall downside exposure, for now. Muni issuers face reduced property taxes as valuations decline and sales taxes fall due to less activity in metro centers. Even for those cities and counties that are hard-hit by remote work and high vacancy rates among offices, we do not project dire straits. The diversification of muni issuer's revenues and the lag with which falling real estate prices will trickle through into tax levies mean that local governments have plenty of time to react to the evolving situation, and they have ample tools to do so, in our view.
- WeWork is a bellwether for ongoing issues within the office CRE market. We continue to hold a negative view on office fundamentals as we have concerns over future utilization of office space and high levels of sublease vacancies. We believe newly built properties will outperform older construction in fundamentals and price growth as they are better positioned to attract tenants.

Sector settings overview

Moderately Bullish	**Municipal Bonds (munis)**	Elevated yields combined with stable fundamentals should continue to support demand. Restricted new supply should provide an additional tailwind.
	US Treasury Inflation-Protected Securities (TIPS)	Break-even inflation rates have fallen substantially and make TIPS an attractive hedge against any reacceleration in US inflation rates.
Reason for Optimism	**Collateralized Loan Obligations (CLO)**	Although CLO credit fundamentals have recovered, if rates remain higher for longer than the market anticipates, lower-rated loan issuers may face pressure, resulting in increasing downgrades and defaults from current levels.
	European Investment-Grade (Euro IG) Corporates	With both higher yields and spreads around long-term averages, we feel investors are compensated for risks associated with a slowing economy.
	Mortgage-Backed Securities (MBS)	MBS origination has declined due to seasonal effects and higher mortgage rates; we anticipate mortgage origination will remain muted amid higher rates and supply constraints in the housing market.
	US High-Yield (HY) Corporates	Amid the high interest rate environment, we expect lower interest coverage, gradual increase in defaults from historic lows, and divergence in earnings between winners and losers to persist.
Neutral	**Asset-Backed Securities**	We expect a pickup in delinquencies and charge-offs to continue as the economy slows next year; we also expect the rise in rates to disproportionately impact subprime borrowers.
	Emerging Market (EM) Corporates	The rally has left spread levels looking less interesting than previously in the year; however, we do still see what we consider pockets of attractive relative value.
	Emerging Market (EM) Sovereign Debt	Reduced fears around a global recession and stronger credit fundamentals remain supportive for spread compression across EM debt.
	European High-Yield Corporates	In the context of rising default rates and tightening monetary policies, we believe the current yield should be able to offset such headwinds.
	Floating-Rate Loans	As growth and margins moderate and higher rates continue to be a headwind to cash flows, we believe stress in the loan market should remain highly idiosyncratic and careful credit selection critical.
	Non-Agency Residential Mortgage-Backed Securities (RMBS)	Factors such as locked in home price appreciation, lower household leverage, strong underwriting standards and a healthy labor market should keep mortgage credit performance stable in the near term.
Reason for Concern	**Commercial Mortgage-Backed Securities (CMBS)**	We expect commercial real estate prices to continue declining due to higher interest rates, higher rate volatility, tighter credit conditions and more conservative cash flow growth assumptions.
	Eurozone Government Bonds	The ECB's hiking cycle seems to have reached an end, but policymakers will likely opt for an extended pause before a first rate cut.
	US Investment-Grade (IG) Corporates	Our base case calls for spreads to widen in the coming months with fundamentals weakening on the margin as the economy slows.
	US Treasuries (USTs)	We feel that the market's projections for overly aggressive timing and amount of Fed policy tightening has led to yields that are too low across the entire curve.
Moderately Bearish	**Global Sukuk**	We still see sizable risks in the Sukuk market, including the impact of lower energy prices and higher interest rates. With concern for potentially wider spreads going forward, we are positioned in higher quality credits that we believe have the financial buffers to manage slowing economic activity.
Bearish	**Japanese Government Bonds (JGBs)**	The Bank of Japan (BoJ) has yet to make substantial moves to address increasing inflation. Yields are most likely to move higher over the medium term, making JGBs unattractive, in our assessment.

Overall risk outlook

Reason for concern

We have not changed our overall risk outlook from neutral with reasons for concern. While there are pockets of value in the market, spreads overall still appear rich. Across many sectors, spreads are well within 10-year averages, but we feel risk levels are above average and not reflected in the recent spread tightening. Our improved US economic outlook has led us to reevaluate our views on spread sectors, particularly in corporate credit. While we expect a modest widening of spreads over the next couple of quarters, the appeal of locking in high levels of yields is attractive to us on a buy and hold basis. However, volatility in UST yields and sector spreads have us looking for better entry points for actively managed portfolios. Sector and security selection will continue to be a focus of our efforts as leaning into wholesale risk is not prudent in this slowing global economic growth environment.

Key sector viewpoints

Moderately bullish

Municipal Bonds (Munis)
Considering heightened market uncertainty, investor demand for tax-free munis remained muted throughout 2023. However, we believe that asset allocators retain high cash balances, waiting on the sidelines for volatility to decline or compelling opportunities to arise. The elevated yields now offered should help to draw funds back into this sector. Technical conditions are more constructive for taxable munis, driven by restricted new supply. Generally speaking, muni issuer fundamentals are stable. Even though state and local government revenue growth is slowing (a side-effect of easing inflation), this does not currently raise our concerns. Issuers have many tools at their disposal to close budget gaps and address any potential headwinds. We therefore retain our moderately bullish outlook on the muni bond sector and believe there are opportunities to find value across the credit spectrum.

Reason for optimism

European Investment Grade (Euro IG) Corporate Bonds
Euro IG bonds performed well last year, thanks to strong corporate balance sheets, low leverage and healthy cash balances. The recent Euro IG earnings season revealed some challenges ahead that could result in a modest deterioration in credit fundamentals among non-financials, although profit margins are holding up well despite slowing sales. European banks are the standout sector, with solid earnings in a higher-rate environment. Many banks have upwardly revised their guidance for the coming fiscal year, as balance sheets show high asset quality and strong liquidity. In our analysis, valuations are attractive for the overall asset class, with Euro IG yields and spreads hovering above their long-term averages. While the macroeconomic environment is likely to remain sluggish, we view the balance of risks as neutral with reasons for optimism, with the attractive interest-rate carry likely to offset any moderate spread widening.

US High-Yield (US HY) Corporate Bonds
An attractive yield combined with discounted bond prices creates a favorable risk/reward outlook for US HY, in our opinion. Technical conditions remain favorable with limited net new issuance and the prevalent use of proceeds to fund refinancing of existing debt. Rising stars (bonds upgraded to IG) and muted new issuance have provided strong technical support this year. We expect the US HY market will largely be able to handle current maturity schedules as corporations have been actively addressing their upcoming financing needs. We expect defaults to gradually increase from historically low levels, but not spike too alarmingly, amid the higher-rate environment as companies with weak business models or overleveraged balance sheets are exposed. With average discounted US HY bond prices having risen above US$90 relative to par, the convexity profile remains attractive, and the pull-to-par will be a strong force driving returns. We remain focused on individual security selection, avoiding issuers we deem excessively leveraged.

Key sector viewpoints (continued)

Reason for concern

US Treasuries (USTs)

Our view on USTs remains dependent on current yield levels. With current volatility, we have seen the 10-year UST move above 5.0%, where we were constructive on a neutral duration stance. However, since then a significant retracement has happened and, at the time of writing, 10-year yields have fallen to just above 4%, leading us back to neutral with reasons for concern.[6]
The case for the speed and quantum of Fed rate cuts priced into the market for next year (over 150 bps), is not supported by incoming economic data. We still believe that cuts starting toward the second half of the year make more sense, but considering the Fed's dovish pivot in December, cuts beginning earlier in the year would not come as a surprise. This is keeping shorter-term UST yields lower than our projections. Similarly, for longer-maturity USTs, we look to be modestly underweight at current levels, but ongoing volatility has us adjusting positioning as we navigate through the next few quarters. We believe Treasury Inflation-Protected Securities (TIPS) still offer value as a hedge against higher inflation, as break-even inflation rates remain below our projections, and monthly accruals continue to be a source of returns.

Bearish

Japanese Government Bonds (JGBs)

We maintain our bearish outlook on JGBs amid expectations of further monetary policy tweaks by the Bank of Japan (BoJ). While the central bank kept policy settings and forward guidance unchanged in December, Governor Ueda acknowledged that the economy was getting there. Core inflation continues to be sticky, which is now reflected in services prices and in nascent signs of a wage-price spiral. Although the BoJ has been slow in policy normalization thus far, we expect an eventual exit from the ultra-loose policy in the first half of this year, which would support higher yields. But a dovish Fed and possible Fed rate cuts will put a ceiling on how high yields can go unless the BoJ turns ultra-hawkish, which we think is unlikely. Meanwhile, we remain of the view that only a substantial move from the BoJ will put yen appreciation pressures back on track, with possible divergent monetary policy versus the Fed also helping. But the trade remains mired in uncertainty given the BoJ's crawling pace so far.

Fixed Income Views: Franklin Templeton Fixed Income conducts a team-wide Quarterly Research & Strategy Forum driven by independent macroeconomic, fundamental sector, and quantitative research, to explore and collaborate on economic and investment outlook. These Fixed Income Views reflect the outcome of this investment forum. An evaluation of macroeconomic conditions and developments across the world's regional economies serves as the backdrop of our investment process, with an eye toward identifying potential changes in fiscal and monetary policies, market risk premiums and relative valuations. From a bottom-up perspective, we provide readers with condensed high-level summaries of our sector views. These macro and sector recommendations are utilized to guide asset class conviction and portfolio construction.

Editorial review

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About Franklin Templeton Fixed Income

Franklin Templeton has been among the first to actively invest in many sectors of the fixed income markets as they have evolved—covering corporate credit, mortgage-based securities, asset backed securities and municipal bonds since the 1970s, international fixed income since the 1980s, bank loans since the early 2000s, and digital assets since the 2010s. Over 145 investment professionals globally support the portfolio managers, who oversee more than US$135 billion in assets under management. Being part of an established investment group at Franklin Templeton gives the portfolio managers access to experts across different areas of the fixed income market, helping them to diversify opportunities and risks across multiple sectors.

Our global reach through Franklin Templeton Investments provides access to additional research, trading, and risk management resources. Portfolio managers have opportunities to exchange insights with other investment groups, and collaborate with an independent risk team that regularly examines risk analytics to help identify and address areas of excessive risk exposure within our portfolios.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal.

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.

Asset-backed, mortgage-backed or mortgage-related securities are subject to prepayment and extension risks.

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**.

Investments in **technology-related industries** carry much greater risks of adverse developments and price movements in such industries than investing in a wider variety of industries.

Changes in the credit rating of a bond, or in the credit rating or financial strength of a bond's issuer, insurer or guarantor, may affect the bond's value. **Low-rated, high-yield bonds** are subject to greater price volatility, illiquidity and possibility of default. **Floating-rate loans and debt securities** are typically rated below investment grade and are subject to greater risk of default, which could result in loss of principal. Any companies and/or case studies referenced herein are used solely for illustrative purposes; any investment may or may not be currently held by any portfolio advised by Franklin Templeton.

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