

Product Commentary

Performance Review

- The municipal (muni) bond market, as measured by the Bloomberg Municipal Bond Index, recorded negative total returns for the fourth quarter of 2024 but fared better than US Treasuries. During the period, continued economic resilience and sticky price pressures resulted in a cautious tone from the US Federal Reserve (Fed). While policymakers delivered two 25-basis point (bp) interest-rate cuts, accompanying statements penciled in only two more for 2025, fewer than previously expected. Data for US gross domestic product for 2024's third quarter showed an annualized increase of 3.1%, indicating a modest acceleration from the second quarter's 3.0% expansion. Against this backdrop, demand for muni bonds was robust, and new tax-exempt bond issuance—though higher than that recorded in 2023—moderated somewhat compared with the prior quarter. General obligation bonds fared better than revenue-related issues, while there was no clear trend in performance between lower-rated securities and their higher-quality counterparts. However, high-yield securities fared better than investment grade-rated debt.

QUARTERLY KEY PERFORMANCE DRIVERS

	Duration	Quality
HELPED	Underweight Municipal Bonds with Two to 10 Years to Maturity	Security Selection in A Rated Bonds
	—	Security Selection in BBB Rated Bonds
	—	Overweight Bonds with No External Credit Rating
HURT	Overweight Municipal Bonds with 20 or More Years to Maturity	Underweight AA Rated Bonds
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	—	—

- Overall, duration positioning detracted from relative fund performance for the period, largely due to our overweight to muni bonds with 20 or more years to maturity. On the other hand, our underweight to muni bonds with two to 10 years to maturity contributed to relative performance.
- Security selection boosted the fund's relative returns during the fourth quarter, primarily driven by our selection in A and BBB rated bonds. Rating allocations also contributed to relative performance during the review period, largely due to our overweight allocation to bonds with no external credit rating. This was only somewhat offset by an underweight to AA rated bonds, which hindered results.

Outlook & Strategy

- The quarter saw investor sentiment oscillate between optimism around a resilient US economy and the prospect that a Republican-led government might further support growth, and concerns that this would mean fewer policy rate cuts from the Fed. As a result, total returns were mixed across fixed income asset classes; tax-free muni bonds recorded negative total returns over the three months under review. However, demand for new muni bond sales remained robust, with anecdotal evidence suggesting that many new issue deals continue to be oversubscribed. Going forward, we expect investors to still be drawn by the historically elevated yields on offerings, which can be particularly appealing for those investors who target tax-adjusted income.
- Fundamentals in the muni market remain stable and should be supportive of the asset class over the medium to long term. Healthy economic growth has allowed states, counties and many municipalities to bolster their reserves, which means that they are well-positioned to deal with any potential financial challenges that may arise. The fundamental strength of muni issuers is reflected in a 15-quarter streak of credit rating upgrades outpacing downgrades (as of 2024's third quarter, based on ratings from Moody's Ratings and S&P Global). However, certain tailwinds that have been contributing to credit strength over recent years are waning somewhat. As the economy cools and inflation eases, tax revenue growth across state and local governments is projected to moderate or decline. While we are not worried about a spike in defaults, more challenging conditions will mean that rigorous bottom-up research and strong security selection will be particularly important over the coming quarters.
- In the United States, sentiment indicators across businesses and consumers point to an optimistic outlook, as a Republican-controlled administration is expected to support economic growth in 2025. Some of the policy changes that we anticipate include a more business-friendly regulatory environment—which should boost investment—and increased tariffs, which are causing some uncertainty but are likely to have only a modest negative impact on the economy. What we as fixed income investors will be watching, however, is the fiscal deficit, since President-elect Donald Trump's campaign promises add up to a large increase in government expenditure. Persistently loose fiscal policy might make the Fed's job of getting inflation back to its 2% target even more difficult. Consequently, we expect only a shallow easing cycle in monetary policy. Since we believe that the Fed's "neutral" rate lies around 4% and its policy is unlikely to need to turn accommodative, we might see only one 25-bp rate reduction in 2025. Less easing might mean continued volatility in fixed income markets, which, we believe, can potentially provide attractive entry points into the tax-exempt muni bond sector for investors. We believe there are opportunities to find value across the credit spectrum.

Fund Details

Inception Date	05/03/1993
Benchmark	Bloomberg Municipal Bond California Exempt Index

Fund Description

The fund seeks to provide investors with a high level of income exempt from regular federal and California personal income taxes, with capital appreciation as a secondary goal, by investing in municipal securities of any rating category, including higher yielding, lower-rated securities.¹

Performance Data

Average Annual Total Returns² (%)

	1 Mth	3 Mths	1 Year	3 Year	5 Year	10 Year	Since Inception	Inception Date
Advisor Class - With Sales Charges ^{a,b}	-1.44	-1.14	4.24	-1.07	1.04	2.93	4.98	05/03/1993
Advisor Class - Without Sales Charges ^{a,b}	-1.44	-1.14	4.24	-1.07	1.04	2.93	4.98	05/03/1993
Class A - With Sales Charges ^{a,c}	-5.06	-4.91	0.09	-2.57	0.04	2.36	4.76	05/03/1993
Class A - Without Sales Charges ^{a,c}	-1.36	-1.21	3.99	-1.32	0.81	2.75	4.88	05/03/1993
Bloomberg Municipal Bond California Exempt Index	-1.29	-1.09	1.02	-0.49	0.96	2.23	-	-

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 with sales charge reflect a deduction of the stated maximum sales charge. 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/(800) 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.

Share Class Details

	CUSIP	Ticker	Sales Charges		Expenses		30-Day SEC Yields ³		Taxable Equivalent Yields	
			Max	CDSC	Gross	Net	Without Waiver	With Waiver	Without Waiver	With Waiver
Advisor Class	354025801	FVCAX	—	—	0.59%	0.59%	4.07%	4.07%	8.68%	8.68%
Class A	354025835	FCQAX	3.75%	—	0.84%	0.84%	3.67%	3.67%	7.83%	7.83%

The **Bloomberg California Municipal Bond Exempt Index** is a market value-weighted index of California investment-grade fixed-rate municipal bonds with maturities of one year or more. Source: Bloomberg Indices.

Investment Team

John Wiley
Years with Firm 35
Years Experience 35

Chris Sperry, CFA
Years with Firm 28
Years Experience 29

John Bonelli
Years with Firm 14
Years Experience 14

Michael Conn
Years with Firm 23
Years Experience 31

1. For investors subject to the alternative minimum tax, a small portion of fund dividends may be taxable. Distributions of capital gains are generally taxable.

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

3. The fund's 30-Day SEC Yield is calculated using the net income (interest and dividends) per share earned over a trailing 30-day period (annualized), divided by the fund's share price at the end of that period. It may not equal the fund's actual income distribution rate, which reflects the fund's past dividends paid to shareholders.

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. Portfolios focused on a **single state** are subject to greater risk of adverse economic and regulatory changes in that state than a geographically diversified fund. **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. An investor may be subject to the federal **Alternative Minimum Tax**, and state and local taxes may apply. These and other risks are discussed in the fund's prospectus.

Important 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. A **basis point (bp, or bps)** is one one-hundredth of one percent (1/100% or 0.01%). The **Federal Reserve Board ("Fed")** is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices and a sustainable pattern of international trade and payments.

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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- a. Gross expenses are the fund's total annual operating expenses as of the fund's prospectus available at the time of publication. Net expenses are capped under a contractual agreement, which cannot be terminated prior to 06/30/2025 without Board consent. Actual expenses may be higher and may impact portfolio returns.
- b. Performance quotations for this class reflect the following methods of calculation: a) For periods prior to the fund's Advisor Class inception date, a restated figure is used based on the fund's oldest share class, Class A1 performance, excluding the effect of Class A1's maximum initial sales charge but reflecting the effect of the Class A1 Rule 12b-1 fees; and for periods after the fund's Advisor Class inception date, actual Advisor Class performance is used, reflecting all charges and fees applicable to that class.
- c. Effective 09/10/2018 Class A shares closed to new investors, were renamed Class A1 shares, and a new Class A share with a different expense structure became available. Class A performance shown has been calculated as follows: (a) for periods prior to 09/10/2018, a restated figure is used based on the fund's Class A1 performance and including any Rule 12b-1 rate differential as exists between Class A1 and Class A; and (b) for periods after 09/10/2018, actual Class A performance is used, reflecting all charges and fees applicable to that class.

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